ISSUES CONFRONTING THE 1982 GENERAL ASSEMBLY

Informational Bulletin No. 141

LEGISLATIVE RESEARCH COMMISSION

Frankfort, Kentucky

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The Commission and its staff, by law and by practice, perform numerous fact-finding and service functions for members of the General Assembly. The Commission provides professional, clerical and other employees required by legislators when the General Assembly is in session and during the interim period between sessions. These employees, in turn, assist committees and individual members in preparing legislation. Other services include conducting studies and investigations, organizing and staffing committee meetings and public hearings, maintaining official legislative records and other reference materials, furnishing information about the legislature to the public, compiling and publishing administrative regulations, administering a legislative intern program, conducting a pre-session orientation conference for legislators, and publishing a daily index of legislative activity during sessions of the General Assembly.

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Prepared by
Members of the Legislative Research Commission
Staff

Edited By
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LEGISLATIVE RESEARCH COMMISSION
Frankfort, Kentucky
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This Bulletin has been prepared by the Legislative Research Commission and paid for from state funds.

FOREWORD

This collection of briefs, prepared by members of the Legislative Research Commission staff, attempts to bring into sharper focus some of the major issues which have received considerable legislative attention during the interim. The reports by no means exhaust the list of important issues facing the 1982 Legislature. At the same time the alternatives and comments suggested are neither exclusive nor exhaustive.

Effort has been made to present these issues objectively, unemotionally, and in as concise a form as the complexity of the subject matter allows. They are grouped for the convenience of the reader into the various committee jurisdictions and no particular meaning is placed upon the order in which they are presented.

Staff members who prepared the reports were selected on the basis of their knowledge of the subject matter and their work with the issues during the 1980-81 interim. Most of the staff has worked closely with the interim legislative committees which studied the issues and helped draft some of the proposed legislation.

Vic Hellard, Jr.
Director

Frankfort, Kentucky
August 1981

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Appropriations and Revenue

HOUSE BILL 44

Prepared by C. Gilmore Dutton

Issue

Should the local property tax limitation provisions of House Bill 44 be repealed or amended to allow local governments more flexibility in raising revenues?

Background

House Bill 44, enacted by the 1979 Special Session of the General Assembly, combined full disclosure and public participation provisions with tax revenue benchmarks, to produce an effective mechanism for local property tax restraint. Opponents of the Act, however, say that the restraints are so severe that they are choking the fiscal life from local governments.

To meet the requirements of House Bill 44, local taxing districts (counties, cities, school districts and special taxing districts) must annually perform several functions. The first of these is the computation of a "compensating tax rate." The compensating rate, zero growth rate, or fully rolled-back rate, as it is variously known, is the rate which, when applied to the current year's value of "old year" real property, will produce just the same amount of revenue as was produced from the same property the year before.

Second is the computation of a "maximum tax rate." The maximum rate is the rate which, when applied to the previous year's value of property which appears on the current year tax roll, will produce the same amount of revenue as was produced from the same property the year before. Except for increases in the rate to adjust for loss of taxable property under the Homestead Exemption - and such increases are normally miniscule (the magnitude of one- or two-tenths of a cent), and except for decreases in the rate to adjust for losses in value of property in excess of current year increases in value (a situation which rarely occurs, and then only as a result of annexation), the maximum rate is the rate levied by the taxing district the previous year. The compensating rate, then, acts as the floor for rate setting purposes; the maximum rate acts as the ceiling.

Next, if the local taxing district proposes to levy a rate which will exceed the compensating tax rate, i.e., a rate which will produce more revenue from the real property which was on the tax roll last year than was produced from that property last year, it must advertise and hold a public hearing on the proposed rate. The advertisement must include specified data about the amount of additional revenue the district would earn, in addition to announcing the time and place of the hearing.

Finally, if the local taxing district levies a rate which produces more than a 4% growth in revenue from old year real property, it must again inform local taxpayers through an advertisement, notifying them of its action and advising them of their rights under the law. Those rights involve the filing of a petition which places the question of the tax rate on the ballot at the general election held in November of each year. If the rate is approved by the voters, it stands as levied; if it is defeated, it is automatically rolled-back to an amount which will produce just a 4% increase in revenue from old year real property.

The magic of the 4% level, set into law by the 1979 Special Session, was that a 4% growth in revenue from old year real property plus a 3% growth in revenue from new real property and a 7% net growth in revenue from old and new personal property (the state-wide averages in each of the three years prior to 1979), would give each taxing district an approximate annual 7% increase in revenues. Immediately prior to the General Assembly's coming into special session in 1979, President Carter had asked all elements of business, both private and governmental, to hold wages and prices at or below 7%. Thus, the 7% increase for local governments complied with the President's request.

That House Bill 44 has effectively restrained local tax rates can be seen in the tax rate statistics available for counties and school districts. In the two tax years that have elapsed since House Bill 44 went into effect, 1979 and 1980, only thirteen school districts and ten counties have successfully levied tax rates "in excess of 4%." Seven of the school districts levied the excess rate in 1979; six in 1980; five of the counties levied the excess rate in 1979 and five in 1980. While no official statistics are available regarding the number of unsuccessful attempts to levy rates which would produce more than the 4% revenue growth, several were reported in various newspapers.

An even more dramatic statistic demonstrating the constraining effects of the "full disclosure" provisions of House Bill 44 is the number of taxing districts which have held their tax rates at or below the compensating rate level. During 1979 and 1980, a total of 68 different school districts and 72 different counties levied tax rates at or below the compensating rate. Sixty-two school districts (34% of the total) and 66 counties (55% of the total) levied compensating or lower tax rates in 1979; 42 school districts (23%) and 53 counties (44%) did so in 1980.

The above statistics obviously translate into a very positive experience for Kentucky's property tax taxpayers. But on the other hand, say many local officials, they translate into fiscal disaster for schools and local governments. The promise of a 7% or lower rate of inflation, the premise of the 4% benchmark in House Bill 44, was never realized. Rather, the cost-of-living grew to double-digit proportions, reaching 11.5% in 1979 and 13.8% in 1980. That the local institutions have survived at all, according to their caretakers, is the result of increased efficiency in the delivery of services and the elimination of frills. Any further discrepancies between revenues and operating costs, say local officials, will result in cuts to the necessary and essential services of local governments and schools.

The prospects for narrowing the gap between income and expense appear good for 1981, with the cost-of-living estimated to increase by "only" 8.6% over 1980. Still, there will be a gap, even for those local institutions which realize a full 7% increase in revenue.

Discussion

For those interested in allowing local governments more flexibility in raising revenues, but also interested in retaining the full disclosure and public participation provisions of House Bill 44, there are two general options available. One is to increase the 4% benchmark to some higher, fixed rate; e.g., 6% or 7%. The other is to substitute a floating benchmark, pegged to an increase in the consumer price index (CPI), or a fraction of the CPI, or an economic index designed specifically for this purpose. The supporters of this proposal say that it would give the local institutions sufficient revenues to meet the cost of existing services but would allow the taxpayers the opportunity to vote on increases in taxes of a size necessary to raise revenues for additional services. The taxpayers would have a direct and immediate voice in any proposal to expand government.

Those interested in substantially increasing the revenue raising capability of local governments and schools, while still retaining the full disclosure provisions of House Bill 44, have available the option of removing the 4% benchmark and the petition and referendum provisions, while retaining the public notice and public hearing provisions. The proponents of this position argue that it gives local officials full flexibility to increase revenues (within the maximum tax rate ceiling), but also provides the taxpayers sufficient information to make an informed judgment at the ballot box at the next local officials' election. The fear of reprisal on election day will keep tax rates within reasonable bounds, say the supporters of this approach.

And for those interested in maximum tax rate setting flexibility for local officials, coupled with the opportunity for total taxpayer participation, there exists the option of removing the 4% benchmark and maximum tax rate provisions, allowing local officials to set whatever tax rate they choose, but also allowing the taxpayers to petition for a referendum on any rate above the compensating tax rate. Under this proposal, the public notice and hearing provisions would be retained.

The proponents of this option claim that in the long run it would allow local institutions to realize more revenue than either of the other proposals. With the removal of the 4% benchmark, which they see as a psychological barrier, taxpayers would be more receptive to arguments by local officials for increased revenues. Local officials, knowing that taxpayers could voice their displeasure by voting down the rate, rather than the official, would be more likely to seek revenue increases. An increase in the percentage of signatures of qualified voters necessary for a valid petition could be a partial trade-off for giving the public the opportunity to challenge any tax rate.

Finally, for those interested in returning to the system that existed prior to the enactment of House Bill 44, there exists the option of repealing House Bill 44. The arguments for so doing are that any benchmark below the maximum rate ceiling is too restrictive on local government and school revenues, and that the public notice and public hearing requirements are intimidating to the local officials.

THE KENTUCKY INHERITANCE TAX

Prepared by William Guy Hart, Jr.

Issue

Should the Kentucky inheritance tax be repealed or amended to increase exemptions and reduce the tax rates for favored beneficiaries?

Background

The Kentucky inheritance tax began in 1906, and is our next-to-oldest general tax. Thirty states besides Kentucky impose an inheritance tax, and all states except Nevada impose some form of death tax, whether it is an inheritance, estate, or pick-up tax. For purposes of clarification, an inheritance tax is one imposed on the value of the share of a beneficiary of a decedent, while an estate tax is a single levy on the value of the entire estate of the decedent. A pick-up tax refers to a tax which allows a credit to the taxpayer against any federal estate tax liability for state death taxes paid. Every state imposing an inheritance or estate tax also has a pick-up tax provision.

The inheritance tax is probably the most distasteful tax on the books in terms of taxpayer acceptance. People simply cannot accept the proposition that the accumulated wealth of a lifetime of work and paying taxes should be taxed again at their death. Several theories of death taxation have been offered to justify the imposition of death taxes. The earliest justification offered was that the privilege of transferring property at death is purely a creation of law, and therefore the government has the right to set the conditions and limitations of such transfers. A second justification is that the receipt of property by a beneficiary automatically creates an ability to pay, in the sense that such property is a windfall for the beneficiary. Since it is property which, except for the death of the donor, would not have come into possession of the heirs, a tax on that property would not be burdensome. A third justification is that the taxes imposed at death are taxes imposed on the beneficiaries of unearned income. One other theory is that death taxes equalize opportunity by redistributing wealth, although most state death taxes are not really high enough to accomplish any extensive redistribution of wealth. In the final analysis, however, the real reason for state death taxes, like the inheritance tax, is that they raise substantial amounts of revenue. In fiscal year 1980-81, the Kentucky inheritance tax brought in almost $25 million.

Discussion

Given the substantial amount of revenue raised by the Kentucky inheritance tax and the tight budgetary situation in which Kentucky finds itself as we approach the 1982 General Assembly, it appears unlikely that any attempt at repealing the inheritance tax will be made. Kentucky simply cannot stand the loss of revenue at this time.

The only viable legislative alternatives, therefore, are to increase the exemptions allowed to beneficiaries under the present law, and reduce the tax rates on transfers exceeding the exempt amounts. Exemptions of inheritable interests are currently granted to three classes of transferees. Class A transferees: a $50,000 exemption is granted a surviving spouse, a $20,000 exemption is granted infants or children who have been declared incompetent or mentally disabled, and a $5,000 exemption is allowed all other children, step-children, parents or grandchildren of the deceased. Class B transferees, which includes brothers, sisters, nephews, nieces, daughters-in-law or sons-in-law, and aunts or uncles, are granted a $1,000 exemption. Class C transferees, granted a $500 exemption, include all other transferees. For the most part such transferees are educational or religious institutions, charities, and persons not related to the decedent. If the intent of the legislature is to reduce inheritance taxes on those persons who are the most natural recipients of the decedent's estate, then a general increase in the exemption for the surviving spouse and children would accomplish this purpose.

A 1974 study of the inheritance tax performed by the Department of Revenue revealed that over 70% of all transfers went to Class A transferees, and specifically to the surviving spouse and children. Bearing in mind that no federal estate tax is due unless the gross estate exceeds $175,000, a decedent in Kentucky might avoid any death taxes whatsoever by leaving his entire estate to his surviving spouse and children, if the exemption for them were increased sufficiently.

Inheritance tax rates on those transfers which exceed exempt amounts currently range as follows:

Class A from 2% on its value not exceeding $20,000 to 10% on its value exceeding $500,000; Class B from 4% on its value not exceeding $10,000 to 16% on its value exceeding $200,000; and Class C from 6% on its value not exceeding $10,000 to 16% on its value exceeding $60,000. Once again, if legislative intent is to ease the burden on the most natural recipients of a decedent's bounty, then the Class A rates could be scaled down even further to accomplish that goal.

INDUSTRIAL REVENUE BONDS

Prepared by Robert L. Doris, Jr.

Issue

Should KRS 103.200 to 103.230 be amended to control or eliminate the use of industrial revenue bonds for such commercial enterprises as financial institutions, office buildings, medical facilities and wholesale and retail sales facilities?

Background

The 1980 General Assembly approved in its passage of House Bill 462 the use of industrial revenue bonds for the above stated purposes.

Even though issued by a city, county or metro government, such bonds create no financial liability to the issuing governmental body. The property being developed becomes security for the bonds and in case of default the bond holders absorb any loss. The credit rating of the governmental unit is unaffected by the sale or default of an issue. The industrial revenue bond program allows the issuer in effect to transfer its tax-exempt status to a private concern. "Tax-exempt status" means that the interest earned on the bonds by the purchaser is exempt from federal tax. During the 1980-82 Interim there have been forty-six projects of this type approved, totaling $139,760,000.

Retail merchants have strongly objected to industrial revenue bonds. This objection is based upon the feeling that tax-fee bonds constitute a federal subsidy to the establishment in their communities of competition from large out-of-state corporations. Out-of-state developers and corporations are building with tax-exempt financing, thus gaining an unfair competitive advantage over established businesses, these merchants maintain.

Opponents feel this program tends to add to the problems of downtown core areas by drawing trade to shopping centers and, in some cases, moving anchor businesses from downtown to shopping centers on the edge of town. They also feel they are unable to take advantage of similar funding, even though they may be eligible, due to the administrative costs of floating a small issue (less than $200,000). Many opponents completely object to the concept of industrial revenue bonds being used in the commercial area, and feel they should be restricted to manufacturing development.

Other opponents of the commercial use of industrial revenue bonds object that smart corporate controllers are capitalizing on the program and utilizing this type of financing on projects that would come about even if the tax exempt bonds were not available. Such projects, they maintain, would be financed by corporate funds or conventional financing. Some examples of corporations using industrial revenue bonds extensively are K-Mart, Kroger, Super-X Drugs and McDonalds. Another objection expresses the fear that saturation of the market with industrial revenue bonds is going to hinder the sale of municipal bonds for such essential projects as roads, water, and sewer systems.

The proponents of this program say that the primary purpose of industrial revenue bonds is to create employment and promote the economy. They argue that retail commercial business in today's market creates more employment than the traditional industrial area. Commercial development does this by creating employment and business activity, as well as generating more state and local taxes through sales tax, income tax, and local property tax.

Proponents claim that the purchasers of industrial revenue bonds are going to buy some form of tax exempt paper anyway and thus these purchases have no real effect on the overall market. They also argue that the conventional market is so bad that if any development is to occur at all it will have to be through the industrial revenue bond route. Conventional financing for large development runs as high as 2 points over prime with floating interest rates, plus 20% to 25% ownership participation by the lender. They also argue that as long as federal paper is paying such high interest, major investors will go that route rather than investing in the conventional bond market.

The House Ways and Means Committee in Washington has expressed concern over the increased usage of industrial revenue bonds by large retail corporations. They feel that the treasury is thus losing millions of dollars in revenue each year. The Committee is considering recommending some controls at the federal level. Some proposals are (1) a uniform reporting system for all states, (2) a dollar cap on issues for each state, (3) geographic targeting for commercial issues to distressed areas, (4) geographic targeting for all industrial revenue bonds (including industrial issues), (5) more restrictive targeting of industrial revenue bonds toward small business (eliminating corporate use) and (6) eliminating commercial industrial revenue bonds completely.

Discussion

There appears to be an agreement among the states that some form of uniformity in reporting is necessary and that some type of targeting approach would be appropriate. The proponents feel that a dollar cap for each state would be difficult to administer but that elimination of all commercial industrial revenue bonds would not be helpful to the economy.

If geographic targeting of commercial issues is restricted to distressed areas, it may have the effect of killing the commercial use of industrial revenue bonds. A potential bond purchaser may be hesitant to invest in a commercial enterprise in an area which is already depressed.

If geographic targeting for all industrial revenue bonds is used, it may have the effect of tying commercial use and industrial development to distressed areas. When an industrial development is approved, for such an area, it will bring jobs and money to an area; a commercial project to recycle the money and provide additional jobs may also be feasible.

If more restrictive use of targeting is recommended - for example, targeting toward small business and eliminating corporate issues for commercial use - many of the criticisms of the program may be eliminated; however, a problem of defining small business may occur.

The elimination of the commercial use of industrial revenue bonds will solve some of the problems, but it could result in an overkill and eliminate some possible good projects which could complement an industrial project.

A cap on the dollar amount that may be issued will be difficult to administer on any grounds other than on a first come, first served basis. This approach could delay or kill good projects which may arise late in the period, after the maximum has already been issued. This approach would also cause concern to an administering agency in trying to determine which of the projects in review may be the best for the area, if it is only able to approve one of them.

COMMONWEALTH CASH MANAGEMENT

Prepared by Tanya Gritz

Issue

Should the Commonwealth revise its cash management practices?

Background

At least three recent developments have mandated consideration of improved cash management practices. Interest rates, and therefore opportunity costs, have risen to a new, apparently consistent, high. Increased revenues from non-tax sources are particularly important to minimize the need for increasing taxes. And, since the advent of sales and coal severance taxes, there are considerable cash balances idle for various lengths of time. Because of these factors, the state has an opportunity to increase revenues by an estimated $50 million per year, by better managing and investing idle balances.

Discussion

Some of the measures that would increase earnings are administrative in nature and do not require legislative action to implement. Several measures, however, would require a revision in existing statutes.

Broaden investment alternatives: Current statutes permit the Investment Commission (made up of the Governor, Treasurer, and the Secretaries of the Departments of Finance and Commerce) to invest idle state funds in U.S. government debt obligations, and debt obligations of the Commonwealth of Kentucky. The Treasurer may place funds in interest-bearing certificates of deposit in Kentucky banks. Several other instruments are available, quite secure ones, with generally higher earnings rates, but Kentucky funds are not permitted to be invested in them. These other instruments include the following, which are fully guaranteed by the U.S. government: Export/Import Debentures, Farmers Home Administration Notes, Federal Home Loan Mortgage Bonds, Governmental National Mortgage Association Securities, and Merchant Marine Bonds. Others in which Kentucky cannot invest are not guaranteed by the U.S. government, but are considered quite secure. These are issues of: Federal Intermediate Credit Banks, Banks for Cooperatives, Federal Land Banks, Federal Home Loan Banks, and the Federal National Mortgage Association. Finally, commercial paper and negotiable certificates of deposit of the top 50 U.S. banks are considered appropriate for government investment.

Establish target earning rates and investment guidelines: Heretofore, investment options have been so limited that a detailed investment policy was not critical. If options are broadened, a means to assure appropriate investing is needed. It is within the purview of the Investment Commission to formulate clear guidelines, specifying proportions and types of securities in which state funds should be invested. Even without a broadening of options, it is still advisable to have specifications for investing of funds in certificates of deposit and U.S. treasury obligations, determining the appropriate maturities, and setting earnings rates. Currently those decisions are made by the Department of Finance and the Treasurer. The statutes are not completely clear about who actually has the responsibility to set interest rates earned on state investments.

Currently the Treasurer establishes interest rates received on investments. KRS 41.380 implies that the Investment Commission should set rates on government obligations. KRS 41.240 says the Treasurer is to set rates on certificates of deposit. The Treasurer feels that setting all earnings rates is his elected responsibility, but it would appear that the Investment Commission also has a role.

It would permit greater public accountability and clarify existing statutes if earnings rates were targeted according to a published, publically reviewable rate. The rate policy could be a part of the published investment guidelines.

Increase the role of the Investment Commission: Currently the Investment Commission meets irregularly and does not print minutes of meetings. Due to the increased opportunities to earn revenue by investing idle public funds and the responsibility to maximize the use of public funds for the welfare of the citizens of the Commonwealth, the role of the Investment Commission is important in reviewing cash management and investment performance. In addition to setting investment guidelines and reviewing performance of investments, the Commission can serve as a public forum for all cash management policy, including also review of banking services, and periodic review of the handling of all state and quasi-state monies (retirement funds, university funds, bond revenues).

Replace pledging with an alternative means of security: Currently banks are required to pledge U.S. government obligations and certain Kentucky municipal bonds in the amount of 110% of the value of state deposits to secure the deposits. This requirement is restrictive on banks' ability to manage their own portfolios and it costs the state from 1/2 to 1/4 of one percent in interest earnings. Some other states have either reduced the level of pledging required or provided an alternative to pledging altogether; deposit insurance, for example.

Pledging, as it exists, does provide security, although the actual market value of the security may not in fact equal 110% on a specific day. Some also argue that without pledging, the market for Kentucky municipals, school bonds particularly, would be significantly thinner, resulting in higher borrowing costs for schools. Without pledging requirements, Kentucky bond prices will have to rise to be competitive with other higher yielding bonds which are also tax-free. Banks will always need a certain amount of tax-free investments.

Others note that banks can already pledge U.S. government and government agency obligations with after-tax yields equal to that of Kentucky school bonds, yet school bonds continue to sell. Pledging alone, therefore, does not significantly strengthen the market for Kentucky municipals.

There is also the argument that perhaps school bonds should not be subsidized by reduced earnings on state deposits as a result of pledging. Consequently, if the latter arguments are true, eliminating the cost of pledging would outweigh a minimal harmful effect on certain municipal bonds.

Implement services contracts with banks providing services to the state: Currently the state of Kentucky does not hold a contract for banking services. As cash management becomes more defined, more and more very specific services will be required. Without a contract, costs to the banks for providing services and the expense to the state for receiving services are only loosely determined. A non-defined method of operating makes the state's costs for banking services unclear and makes shopping for the best vendor of services based on cost and performance impossible.

Considering the high volume of banking services the state requires, the cost of services is potentially large. Consequently, an effort should be made to minimize those costs. The kind and amount of banking services required could be specified clearly, and bids received for those services, as is the case in the purchase of most services for public use. To allow for public accountability, these bids could then be opened and the best selected at an open meeting of the Investment Commission. It is not necessary that the total range of needed services be provided by one bank. Different sevices could be divided among a few banks to allow for specialized capabilities and geographical considerations.

Permit electronic funds transfer: The ability to move large sums of money out of the Treasury quickly is a requirement of an aggressive cash management program. This feature is especially important to purchase investments on a timely basis and to effectuate an efficient overnight investment program. Also, EFT speeds fund availability and therefore increases opportunities to earn interest.

Currently, funds can only be withdrawn from the Treasury by check. This is time-consuming and therefore costly.

CONSTITUTIONAL AMENDMENT ALLOWING GENERAL ASSEMBLY TO APPROVE GENERAL OBLIGATION BONDS

Prepared by John Downard

Issue

Should the Kentucky General Assembly propose a constitutional amendment allowing the issuance of general obligation bonds upon the affirmative vote of at least 3/5 of each house?

Background

Section 50 of the Kentucky Constitution prohibits state government from incurring more than $500,000 in general obligation debt without voter approval in a statewide referendum. To circumvent this constitutional provision twenty-one agencies and authorities have been granted power to issue project revenue bonds (as opposed to general obligation bonds). Most debt service payments on state revenue bonds are made from tax revenues, however, and not from revenue generated from the project. The Commonwealth could not feasibly allow revenue bonds issued by the authorities to default. Such an action would severely impair Kentucky's ability to borrow and would greatly increase interest costs on future bond issues.

Interest rates on general obligation bonds average from 1/2 to 1 percent less than those on revenue bonds of identical ratings and maturities. Kentucky plans to issue over $700,000,000 of new non-self-retiring bonds in the 1980-82 fiscal biennium. If these bonds were sold as 30-year general obligation bonds at an interest rate of one-half of one percent lower than that of revenue bonds, the savings would probably exceed $70,000,000. If the interest rate differential were one percent, the saving could approach $150,000,000.

The Committee for Program Review and Investigation has recently completed an intensive study of bonded indebtedness, which examined all facets of long-term debt issued by the Commonwealth. One of the study's recommendations was that the Kentucky Constitution be amended to enable the Commonwealth to issue general obligation debt upon the affirmative vote of at least three-fifths of each House of the General Assembly.

Discussion

The first benefit of issuing general obligation bonds is that it would save the taxpayers millions of dollars in interest costs. The 1/2 to 1 percent difference in interest costs would provide substantial savings to the state, although funds for debt service would be derived from the same sources as they are currently. The substantive difference is that the Commonwealth would pledge its full faith and credit to payment of interest and principal.

The second major benefit would be that proposed bond issuances would be discussed and voted upon separately, as opposed to being included in the budget act as they are now. Decisions would be made by a larger, entirely elected body rather than by a Commission composed primarily of individuals appointed by the Governor. The approval of this amendment would not require the state to issue solely general obligation bonds, but merely give it the option to do so in circumstances in which it was felt to be cost-effective.

Finally, the Commonwealth should realize lower preparation and marketing costs for general obligation bonds, since the legal documents are simpler and the marketing activities need not be as extensive as for revenue bonds.

Twelve state legislatures have the power to authorize general obligation debt. Six may do so by a simple majority vote. Three require a three-fifths majority, and two require a two-thirds majority. In Delaware, a three-fourths majority vote is necessary.

The disadvantage of issuing general obligation bonds is that the debt would be legally that of the Commonwealth under any and all circumstances. If such an amendment were approved it would delegate greater responsibilities to the General Assembly when capital and road construction projects are approved.

Banking and Insurance

MUTUAL ASSESSMENT INSURANCE COMPANIES

Prepared by Greg Freedman and Bill VanArsdall

Issue

Should mutual assessment insurance companies doing business in Kentucky be subjected to regulation by the Department of Insurance to the extent that other insurance companies are?

Background

During the past year in Kentucky one mutual assessment insurance company has been liquidated and one is in rehabilitation because of failure to pay claims. There are 22 other companies still operating in the Commonwealth. These companies are the purest form of cooperative activity for handling risk. The policyholders are the owners and they elect the officers and board of directors. The companies issue a policy and charge a premium to cover expenses and small losses. Most of these companies assess the members if additional funds are needed to pay expenses and claims. Under current Kentucky law mutual assessment insurance companies do not have to meet statutory requirements that other insurance companies must meet. For example, they do not have to have their rates approved by the Department of Insurance, are not required to join guaranty associations, and are not required to have their agents licensed. The Department of Insurance has drafted a bill to increase the standards for mutual assessment companies.

Discussion

The mutual assessment insurers fear an overreaction to the recent failures of two companies. Present statutes, they say, would have been adequate to deal with the problem if the Department of Insurance had acted more quickly. They point to the generally good record of mutual assessment companies in Kentucky and note that cooperatives have insured many people who could not otherwise obtain coverage. Greatly increased regulation might drive some of these companies out of business. They feel that they should not be expected to meet the same requirements as larger insurers, because of their different history and function.

The Department of Insurance expresses concern for policyholders, many of whom, it claims, pay premiums to these companies without the knowledge that they may be assessed further or that their insurers may fail financially.

A compromise may be worked out in either of two ways: (1) mutual assessment companies could create their own guaranty fund and remain less regulated than other Kentucky insurers, or (2) mutual assessment companies could join in the general guaranty fund with other insurance companies and submit to additional requirements. These extra duties would include clearly notifying policyholders that they may be assessed further and allowing the Department to examine the companies more thoroughly.

STATEWIDE BANKING

Prepared by Bill VanArsdall

Issue

Should Kentucky banks be allowed to establish branches across county lines? Should Kentucky permit the existence of multibank holding companies?

Background

Cross-county branching. Branch banking exists when a single banking form conducts operations at two or more locations. The head office and all the branches are controlled by the same board of directors and are owned by the same stockholders.

Federal legislation follows each state's preference on whether branching is to be permitted. If state banks are permitted to branch, so are national banks.

Some states prohibit branch banking entirely; others permit branches to be set up anywhere in the state. Currently, twenty states allow statewide branching, fifteen permit only unit (one location) banking, and fifteen permit limited branching.

Kentucky is a "limited branching" state. Branches may be established only inside the county in which the home office is located.

Multibank holding companies. A multibank holding company is one that controls two or more banks. Such companies have existed since around 1900 and have developed primarily in states that limit or prohibit branch banking.

Kentucky law does not permit such companies to exist, but it does allow one-bank holding companies. A one-bank holding company may control only one bank, but it may also control other companies, such as those involved in mortgage banking, data processing, leasing, and industrial loans.

Discussion

Proponents of branch banking say that it leads to better bank management, because of greater resources and training facilities. More skilled people can be employed, and there are increased opportunities for specialization. Branch banking, supporters say, allows geographical mobility of funds, and larger amounts of deposits and capital become available. In addition, there are claims that branching helps a state's economy: banks have a larger stake in statewide economic development if they are allowed to expand. The financing of major projects in small communities becomes easier.

Another argument for statewide branching is that banks will need it to deal with changing conditions. Three significant shifts are occurring in the world of banking: (1) Recent changes in federal law allow increased competition among financial institutions. Savings and loan associations, brokerage houses, credit unions, and other organizations may now offer services previously open only to banks. (2) Home computer systems, two-way cable television and electronic funds transfers are expected to become widely used soon. (3) Barriers to interstate banking are eroding, and the U.S. Congress is considering permitting it. If this change occurs, Kentucky banks could find themselves in direct competition with the largest and most powerful banks in the country. Such a development, say proponents of statewide banking, will create a need for larger, more flexible banking institutions capable of specialization.

There is considerable opposition to expanded branching in Kentucky. Many bankers do not welcome competition from the state's large cities. They claim that branch banks will operate impersonally and ignore community needs. There is a tendency to curtail farm credit with statewide banking, they say, and concentrated banking shifts funds from rural areas, where capital is short, into urban areas. There is a fear that large corporate borrowers will be favored over small businesses and individuals. The services which branch banks can offer their customers are already available through the correspondent banking system, according to independent bankers, and expanded branching does not necessarily lead to lower-priced banking services. Kentucky's independent banks feel they are capable of financing industrial development and contributing to the state's economic growth without a change in the present laws. They also believe that large banks exaggerate the benefits of size. After banks reach a certain deposit level, they say, economies of scale do not exist for most banking services, and some costs may even be higher for large banks than for small ones.

Some Kentucky bankers favor a compromise between the present law and full statewide branching. Multibank holding companies are acceptable to some who oppose full expansion but consider change likely. Restrictions on the number of banks which might be acquired per year by a particular institution have been suggested. There might also be a rule forbidding acquisition of a new bank, one which has existed, say, for less than five years. Banks which become part of a larger system could be forbidden to merge with the parent bank for a given period. Branching could be allowed, but not statewide: a bank might be permitted to set up branches only in counties adjacent to its own or within specified regions of Kentucky.

KENTUCKY HOUSING CORPORATION

Prepared by Bill VanArsdall and Greg Freedman

Issue

Should the $700 million bonding limit of the Kentucky Housing Corporation be increased?

Background

The Kentucky Housing Corporation is authorized by statute to sell $700 million worth of bonds to help provide housing "for sale or rental to persons and families of lower income." This ceiling has practically been reached, and the Corporation can be expected to request an increase in its bonding capacity.

Since the creation of KHC by the 1972 General Assembly, there have been a number of changes in government and in the national economy. The housing market has altered drastically in the last few years. It is more difficult than ever to provide persons of low income with a place to live. In addition, federal programs have been altered since the Corporation was founded. Congress has set strict limits on the financing of single-family housing with tax-free bonds. The federal Section 8 multifamily rental program is being cut back, and permanent financing for construction projects is not as readily available from the Government National Mortgage Association as it used to be.

There have also been changes within the Kentucky Housing Corporation itself. As a result of a reorganization at the executive level, KHC is now attached to the Department of Transportation for administrative purposes. The Corporation drew some criticism recently when it expressed interest in setting up a separate corporation to issue loan notes and provide permanent mortgage financing. This new corporation was to be a source of money not otherwise available because of the Corporation's bonding limit. An opinion of the Attorney General issued June 30, 1981, expressed "serious doubt as to whether the KHC has the power to create the proposed new housing corporation." The Opinion also stated that "any bonds issued through such a device would be subject to the $700 million debt ceiling limitation."

Discussion

The Kentucky Housing Corporation has undoubtedly done a great deal to provide Kentuckians with "decent, safe and sanitary residential housing," pursuant to its statutory mandate. These achievements have been accomplished through single-family loans, loans to lenders, multifamily programs, the Kentucky Appalachian Housing Program and other devices.

There are several questions, however, which have frequently been discussed by members of the Committee on Banking and Insurance. Their concern is whether KHC is fulfilling the role it was created for. Those questions are:

(1) Is KHC directing enough of its efforts at housing poor people? Nowhere in the purposes enumerated in the statutes which created KHC do the words "moderate income" appear. Interest rates and building expenses are now so high that it is extremely difficult to provide housing that persons with low incomes can afford, and much of KHC's help has arguably gone to middle-income Kentuckians. Market conditions and the need to maintain a high bond rating have practically made this a necessity. Is it time for the General Assembly to admit that the Corporation is not aimed at the truly poor and amend the statutes accordingly? Or should it reaffirm its commitment to provide housing for very needy people, bond ratings and market conditions notwithstanding?

(2) Is KHC meeting the housing needs of southeastern Kentucky? Surveys indicate that this is the area of the state with the most severe housing shortage, yet much of KHC's activity is directed toward other regions and toward metropolitan areas.

(3) Is it part of KHC's job to help the building industry in Kentucky? In some other states, similar housing authorities are expressly given this duty by their legislatures. Kentucky's statute, however, aims only at helping poor people find housing. If this is unrealistic, should the statute be changed?

(4) Is the present bonding limit of $700 million appropriate? Should KHC be given more capacity to fund its projects? To what extent is a KHC bond part of the bonded indebtedness of Kentucky, real or perceived? Is the separate corporation which KHC attempted to create an acceptable source of money?

OTHER ISSUES IN BANKING AND INSURANCE

Bank Card Finance Charges

Issue

Should banks be permitted to impose a charge on the use of bank credit cards other than the finance charge of 1.5 percent per month on the outstanding balance presently permitted by statute?

Background

Courts do not consider charges on the extension of credit by a seller in connection with the sale of goods or services as "interest," in that the courts do not consider this credit to represent a loan of money. Therefore, our state usury law and other state laws regulating interest rates on loans do not apply to finance charges. For the most part finance charges are unregulated. It appears that the 1982 General Assembly will be faced with one or more bills pertaining to finance charges on bank revolving credit plans. It seems that bank credit cards, such as VISA and MasterCard, are yielding little if any profits to banks. In an appearance on January 28, 1981, before a subcommittee of the Interim Joint Committee on Banking and Insurance, representatives of the First National Bank of Louisville said their MasterCard operation has shown declining profits since 1976 and is now operating in the red. Increased fraud losses and cost of funds are two of the causes for this situation. The 1972 Kentucky General Assembly enacted KRS 287.720 to 287.770, which regulate bank revolving credit plans. KRS 287.740 limits finance charges on bank credit cards to 1-1/2 percent per month. The statutes do not allow for any other charges, such as annual fees, late charge fees, or over-limit fees. Because of the statutory restrictions, First National and other banks have begun to charge interest at the currently permitted rate on the free days on the customer's true average-daily-balance. If the customer pays the balance in full when billed, he pays the lesser of the finance charge or a $1.50 maximum. A bill has already been prefiled by a legislator to prevent charging a finance charge when the bill is paid in full upon billing. It appears that the 1982 General Assembly will have to consider bills which prohibit finance charges when the bill is paid on time, which increase the maximum finance charge, or which allow other charges, such as monthly or annual charges.

Department of Banking and Securities

Issue

Should fees for bank examinations conducted by the Department of Banking and Securities be placed in a trust fund or the General Fund?

Background

The Department of Banking and Securities charged the 268 state-chartered banks $750,000 last year for bank examinations. These examinations cost the Department $1.3 million. The Department is reviewing its fees and is considering increasing them. The Department would like to become independently funded by allowing fees it collects to remain with the Department rather than being sent to the General Fund. It is argued that bankers will be more willing to pay increased fees if they are assured that the money will go to the Department, where it could be more effectively used to regulate banks.

Credit Life Insurance Rates

Issue

Should the General Assembly change the present law concerning maximum rates for credit life insurance?

Background

Credit life insurance is bought by debtors in connection with the making of loans. It is sold through banks, automobile credit corporations and other lenders as a means of guaranteeing repayment if the borrower should die. A 1970 Kentucky statute reads, "It shall be presumed that premium rates....are not excessive in relation to the benefits" if those rates do not exceed specified limits. As part of an effort to lower credit life rates in Kentucky, the Department of Insurance has declared that it considers this statutory presumption to be rebuttable; the Department has presented evidence at hearings to demonstrate that the rates are too high. At the level specified in the statute, Kentucky's rates are among the nation's highest. Only 27 cents of every dollar paid in premiums is being paid out by the insurance companies in benefits; several national organizations recommend a figure closer to 50 cents per dollar. Presently, after a series of unsuccessful lawsuits against the Department, insurance companies have voluntarily agreed to lower their rates. There may be legislative proposals in 1982 to change the legal maximum or to clarify the statutory language.

Medicare Supplement Insurance Policies

Issue

Should the General Assembly bring Kentucky into full compliance with federal guidelines on Medicare supplement insurance?

Background

Medicare does not offer full health insurance protection for elderly people, but one good additional private policy will fill the gap. Many people buy too much coverage and have overlapping policies, resulting in insufficient protection at a high price. To prevent this happening, the U.S. Congress enacted the "Baucus Amendment" in 1980, providing for federal oversight of Medicare supplement policies, if states do not have necessary statutes and regulations in place by July 1, 1982. The Kentucky General Assembly passed legislation in 1980 which, with subsequent adopted regulations, brings the state very close to compliance. A few statutory changes are still required, however: the law must be made to apply to group policies, certain loss ratios must be set, "free look" provisions must be changed, etc. In order to prevent control of Medicare supplement insurance from being placed largely in the hands of the federal government, Kentucky must put this additional legislation into effect by July 1, 1982. To that end, a bill has been proposed by the Department of Insurance, and it contains an emergency clause.

Responsibility for Insuring State Property

Issue

Should the Department of Insurance have the authority to determine what property will or will not be insured for fire and extended coverage?

Background

The level of insurance coverage varies among agencies. A few agencies choose to limit or not insure, but some agencies may fail to insure due to oversight. Regardless of their reasoning, such agencies may experience a loss which could not be absorbed by the agency; therefore, the responsibility would rest on the Commonwealth. The statutes creating the Fire and Tornado Insurance Fund do not require an agency to insure any or all of the property under its control. The decision to obtain coverage rests entirely with the agency. The optional nature of this requirement results in some state agencies not insuring all of their property. The statute (KRS 56.070) may allow a serious gap between insured vs. uninsured property.

Business Organizations and Professions

THOROUGHBRED RACING

Prepared by Michael Greer

Issue

Should the Kentucky General Assembly pass legislation to provide for more effective regulation of and financial relief for the thoroughbred racing industry in Kentucky?

Background

Along with bourbon whiskey and tobacco, thoroughbred horses are one of the primary industries in Kentucky, possibly the one for which Kentucky is best known. The thoroughbred industry makes a major contribution to the economy of the state. A recent study commissioned by the thoroughbred industry, documented for the first time the actual contribution.

According to the study, the thoroughbred racing and breeding industries have in excess of 1.5 billion dollars invested in Kentucky. In 1980, the thoroughbred industry accounted for a direct cash flow of $253.5 million to the Kentucky economy. When the multiplier effect of this money is felt as it moves through the economy, the total annual economic impact is approximately $750 million.

During the last five years, the industry has begun to feel the pinch of inflation, however. Also during the period, a number of policy issues have surfaced. Four resolutions calling for a study of the thoroughbred racing industry were introduced in the 1980 General Assembly. Two of these resolutions passed (HCR 94 and SR 61) and their requirements were combined into one study. A special task force on thoroughbred racing was created, as directed by HCR 94, to conduct a study of issues contained in both resolutions, as well as any other issues which might be identified.

Discussion

The following six major areas have been the focus of the Task Force's study:

Authority and Function of the Racing Commission. One of the primary issues in this area is the size and composition of the State Racing Commission. By statute, the Racing Commission is comprised of five members, three of whom must be breeders. This composition has come under criticism, even by the Governor, who, in his appointment of the new chairman of the Racing Commission, commented that Kentucky needed a racing commission and not a breeding commission. A group which has strong feelings about not being represented is the Horsemen's Benevolent and Protective Association (HBPA), with a membership of owners and trainers.

In May, 1980, the Governor, by executive order, increased the membership of the Commission to nine members and appointed new members from diverse areas. This reorganization will, of course, need to be ratified by the 1982 General Assembly. Whether the size of the new commission and its composition addresses the need for representation will be at issue during the session.

Another issue in this area is the broad statutory authority of the State Racing Commission to regulate racing. The statutes grant the Racing Commission "forceful control of thoroughbred racing . . . with plenary power to promulgate rules and regulations . . ." This is possibly the broadest grant of authority to any agency contained in the statutes.

For many years the board authority was not questioned, but in recent years it has been the subject of criticism. The HBPA has challenged certain policies of the Commission and the Administrative Regulation Review Subcommittee has rejected several regulations they felt were not consistent with legislative intent. These actions have raised the question of how much authority the Commission should have and what areas of racing they should be regulating. Any attempts to state the Commission's authority more specifically should not overlook the need to maintain some flexibility for dealing with contingencies.

Another issue in this area is Sunday racing. Prior to 1978, Kentucky law expressly prohibited racing on Sunday. The law was amended then, but the Racing Commission continued to deny requests for Sunday dates. This year, the Commission denied Sunday racing for Churchill Downs, but, as an experiment approved it for Latonia. Recently, Sunday racing was approved for Ellis Park.

Sunday racing in other states has increased revenue for tracks. In some states, Sunday racing pulls a bigger attendance and "handle" (total wagered) than any other day. By trading a poorer day such as Tuesday for Sunday, total revenues are increased, with little or no increase in costs. At issue here is whether the Commission should have to approve Sunday racing or whether the tracks themselves should make the decision, based on their particular market situation.

<u>Medication.</u> Perhaps the hottest issue in thoroughbred racing is the use of medication. Narcotics, stimulants and other drugs which either stimulate or depress a horse's system, have been prohibited in racing almost since racing began. The controversy concerns certain types of therapeutic medications which have come on the racing scene in recent years for the treatment of chronic ailments and to keep horses fit for racing. The two principal medications involved are phenylbutazone, or "Bute," used in treating inflammation associated with musculo-skeletal problems, and furosemide, or Lasix, a diuretic used in the treatment of epistaxis or respiratory bleeding. Due largely to publicized abuse of these medications and the threat of federal intervention, a number of states have adopted rules to prohibit the use of medication on race day.

In July, 1980, the State Racing Commission adopted a restricted medication rule based on a model rule prepared by the National Association of State Racing Commissioners. In November, before the rule had been approved, the Commission withdrew it in favor of a "no medication" rule. The latter rule was subsequently rejected by the Administrative Regulation Review Subcommittee and the Interim Joint Committee on Business Organizations and Professions as not conforming with legislative intent.

The major argument against Bute is that it makes a horse think he is well and can thus contribute to further injury or possibly total breakdown and destruction. The only data supporting this contention is casual data from a small track in West Virginia and one in Pennsylvania. A study of medication in California showed no correlation between breakdowns and the use of Bute and indicated possible preventative effects. Similar conclusions were drawn from statistics in Colorado. Kentucky statistics show no significant increase in breakdowns with the legalization of Bute. Research on the drug conducted at the University of Kentucky and funded by the Racing Commission suggests that total prohibition is not warranted.

The argument against Lasix is that it can mask the presence of illegal drugs. When Lasix is administered, it causes a great increase in the amount of water expelled from the body. During this period, an illegal drug could be diluted in the urine sample to the point that it is not detectable. The period of severe dilution is short, however, lasting only two to three hours. Recent research at the New Bolton Center, University of Pennsylvania, indicates that Lasix is extremely effective in treating and even preventing bleeding.

There is no evidence which would support a complete prohibition on medication. It appears that the rush to adopt "no medication" rules is primarily a reaction to the threat of federal intervention in the area. Past statements made by President Reagan, however, suggest that his administration would not support such legislation, which would make its passage, at least in the near future, highly improbable. What the 1982 General Assembly will have to decide is how to deter possible abuses of these medications and at the same time permit therapeutic uses.

Pari-Mutuel Tax Reduction. Kentucky law places a 4-3/4% tax on pari-mutuel wagering. Three quarters of a percent goes to the Thoroughbred Development Fund and is eventually returned to the industry. A net of 4% goes to the general fund.

Last year, the thoroughbred racing industry commissioned a consulting firm to conduct a study of the economic condition of the industry. Using data from the past ten years, the consultants project continued declining revenues over the next five years, with two tracks showing significant losses. The consultants recommend that Kentucky take a "bold, decisive step" in substantially reducing the pari-mutuel tax so that more revenue will stay in the industry.

The projected loss of state revenue from a significant reduction would be between $4 and $8 million per year. In the present budget situation, any tax reduction, particularly one favoring racing, would be extremely difficult to pass. Whether a tax reduction is justified depends in large part on whether the pari-mutuel tax is perceived as a tax on the industry or a tax on the consumer.

There are basically three ways of increasing revenues to the racing industry: redistribute existing revenues so the industry keeps more, attract more fans, which will bring in more revenues, and extend the methods by which patrons may wager. The solution to the financial dilemma of the racing industry probably lies in a combination of these approaches. One possibility would be for the state to grant racing a three- or four-year declining tax reduction in exchange for a greater share of future off-track revenues. When coupled with self-help programs agreed to by the industry, the total package becomes a state investment in the future of the racing industry, rather than a bail-out.

Off-Track Betting. A 1974 Legislative Research Commission report recommended instituting off-track betting in Kentucky. No action was taken on the recommendation, since the racing industry at the time was opposed to off-track betting. Because of current economic conditions, the racing industry has come out in support of a "well conceived" off-track betting system. A public opinion survey taken for the LRC study revealed that a majority of the public in 1974 supported off-track betting.

One segment of the Killingsworth-Liddy study commissioned by the industry looked at off-track betting. Twelve different off-track betting systems were reviewed and the expenses and revenues, as well as risks involved, were analyzed. Additional revenues derived from off-track betting were estimated from a loss of $1 million to a gain of $17.8 million, depending on the system. All factors considered, a system of television theaters at the dark tracks seems to be the most viable, at least initially. According to the wording of the statutes, implementation of this system would not require enabling legislation, although any extension of off-track betting beyond track premises would.

Qualifications and Training of Officials. One of the areas specified for study in the resolution creating the Task Force was the qualification and training of racing stewards. It was found that no training is provided for racing officials, who are expected to gain the knowledge they need through experience. In 1978, money was allocated for a training program for stewards, but no such program was developed.

In conducting research on this issue, it was noted that Kentucky, one of the leading thoroughbred states, offers very little in the way of equine education programs. Arizona, whose thoroughbred industry is much less prominent, has a Racetrack Industry Program at the University of Arizona which provides a variety of educational and training opportunities for the racing industry. There is some interest in developing an Equine Institute at the University of Kentucky to provide education, training, and research. University of Kentucky has the facilities at Main Chance Farm and could possibly create such a program with the reorganization of existing resources, provided there was adequate commitment from the University and the racing industry.

Administration of Special Funds. Within the last four years, three special funds have been created, each with an oversight body with varying degrees of autonomy from the Racing Commission. The Kentucky Thoroughbred Development Fund, created in 1978, is funded with three quarters of a percent of the pari-mutuel tax. The money is used to supplement purses for Kentucky-bred horses in an effort to improve the breeding industry. The Kentucky Racing Health and Welfare Fund was also created in 1978. Organized as a non-profit, charitable corporation funded by unclaimed pari-mutuel tickets, this fund provides financial assistance for needy racing personnel or their families. The Backside Improvement Fund was created in 1980 and funded by one-half of a percent of the increased take-out at the two smaller tracks. The purpose of this fund is to finance necessary improvements in the stable area at the two tracks.

The primary issue raised concerns the basic policy of the Racing Commission in supplementing purses through the Thoroughbred Development Fund. The money is now allocated to designated stakes, handicap, allowance and non-claiming maiden races. The Horsemen's Benevolent and Protective Association has recommended that the funds be evenly distributed to all purses. Which of these approaches is the most effective in promoting the breeding industry is at issue.

Another issue involving these funds evolved during the study. It was noted that each fund was operated as a separate entity, with separate oversight and even separate administration. The apparent reason for this was to assure representation by groups who felt they were not represented on the Racing Commission. This approach has created inefficient fragmentation of racing regulation. Some economy of scale may be realized by bringing the funds under the Racing Commission, assuming of course, representation of disenfranchised groups is addressed in the composition of the Racing Commission. There has also been a question raised about the necessity of the Backside Improvement Fund. Other states handle backside improvements through direct tax rebates, which may be a more efficient method.

SMALL BUSINESS DEVELOPMENT

Prepared by Michael Greer

Issue

Should the Kentucky General Assembly enact legislation to promote the development, growth and expansion of small businesses in Kentucky?

Background

Small businesses are the backbone of the American economy, accounting for 43% of the gross national product and approximately 80% of all jobs. During the last decade, small businesses produced 87.6% of all new jobs created in the private sector. Because Kentucky is not heavily industrialized, small businesses mean even more to its economy. In recent years, however, a number of factors have made starting and operating a small business extremely risky. An average of 1,000 small businesses go out of business every day, and half of the small businessses started each year do not last more than five years.

In July, 1980, the Legislative Research Commission created the Task Force on Small Business to study the problems facing small business in Kentucky and develop remedial legislation. From October, 1980, to March, 1981, the Task Force held public hearings across the state to hear about problems directly from small business people. Out of these hearings came a list of small business issues which were referred for further study to three subcommittees created by the Task Force. The Subcommittees corresponded to the major classifications of small business issues: Taxation and Capital Formation, Management and Technical Assistance, and Regulatory Reform.

Discussion

The following is a summary of issues and possible legislation being discussed by the subcommittee. Final recommendations will be made to the Task Force and legislation prefiled by the end of the Interim.

Taxation and Capital Formation. Not surprisingly, one of the most frequently voiced complaints of small business people was taxes. More annoying to small business people than the amount of taxes is the number and complexity of taxes and the paperwork involved. Because of this complaint, a segment of the legislative workshop was devoted to examining Michigan's approach to simplifying business taxes. In 1976, Michigan consolidated eight business taxes into a single tax. It was generally agreed at the workshop that the Michigan tax was not appropriate for Kentucky, but the subcommittee will be looking further into modifying Michigan's approach, as well as exploring alternative ways of simplifying taxes.

Another tax issue concerns ambiguities in administration of the sales tax. The major problem in this area is the use of resale certificate. Any person who has a permit to conduct business in Kentucky may make tax-exempt purchases if he intends to resell the purchased property in his business.

Proponents maintain that the statutes regarding the use of resale certificates place a "burden of proof" on the seller that is only resolved if the resale certificate is accepted in "good faith." They contend that the Department of Revenue holds the seller responsible for remitting the taxes if the Department rules that a purchase was taxable, even if the seller acted "in good faith."

Critics claim that the statutes are already clear in the responsibilities of the seller and that some control over the use of the resale certificates is necessary. The Department of Revenue says that recent steps have been implemented to try to stop the fraudulent use of resale certificates. The subcommittee will be looking at legislation to further clarify statutory language, particularly in regard to burden of proof in accepting a resale certificate.

One tax that small business people maintain is especially burdensome is Kentucky's inheritance tax. Critics of the inheritance tax argue that it reduces the likelihood that small businesses will survive the lifetime of their present owners. The result of this tax is that many small business people or their heirs sell their businesses to avoid the tax or to afford the tax. The Subcommittee on Taxation and Capital Formation, at its May meeting, recommended passage of 82 BR 193, which raises the dollar exemption for different categories of heirs. The Subcommittee amended the draft to extend the exemption for a surviving spouse from $175,000 to $250,000. (The present exemption is $50,000.)

At its June meeting, however, the Subcommittee decided to study the feasibility of phasing out the inheritance tax and eventually adopting a "pick-up" estate tax, which would enable the Commonwealth to collect any estate tax that would otherwise be collected by the federal government. The resulting estate tax would be patterned after Florida's estate tax.

The implementation of tax incentives or credits is another area under consideration by the Subcommittee on Taxation and Capital Formation. The most frequently mentioned tax incentive is for the creation of new jobs. Under this proposal, businesses would earn a tax credit for each new job created and the Commonwealth would, it is hoped, be able to regain the lost revenue through increased collections in personal income tax and sales and use taxes. Other tax incentives that are under consideration include those for (1) hiring of vocational students or apprentices, (2) coal companies starting non-coal businesses, and (3) the use of solar energy.

The final tax reform under consideration by the Subcommittee concerns the corporate income tax. Under the present rate scale, the maximum rate is charged after a business has reached $100,000 in earnings. "Bracket creep," caused by inflation, has put many small businesses in the highest tax bracket. A proposal to raise the maximum to $500,000 in earnings is under review.

The Subcommittee on Taxation and Capital Formation is also discussing possible ways of creating sources of capital, particularly start-up capital for small business development. A meeting in August will be devoted to looking at sources for capital formation, such as creation of a state Small Business Investment Corporation, and targeting the use of industrial revenue bonds for small business development. The Subcommittee will also study the feasibility of streamlining the regulation of intrastate securities.

The primary obstacle to these tax reforms in the 1982 session will be finding the money to fund them. Each of the proposals would result in a loss of state revenues and, with the state already facing a large revenue shortfall, the prospects for tax reform this session are not optimistic.

Management and Technical Assistance. Most people who go into business for themselves are initially inexperienced about business principles and practices. According to Dun & Bradstreet, 50% of all business failures are due to management deficiencies - lack of planning, inadequate controls, poor accounting, and an inability to read and understand financial statements.

Kentucky has a number of programs established to provide assistance in the realm of management to small businesses. It has an Office of Small and Minority Business Development within the Commerce Cabinet, a Center for Business Development at the University of Kentucky, and Small Business Institutes at all the regional universities. There is, however, a general lack of information about these programs.

The Office of Small and Minority Business Development was created by executive order; the Subcommittee on Management and Technical Assistance is considering enacting statutory guidelines and responsibilities for this Office. One possibility being discussed is establishing an information clearinghouse within this office through which individuals could be referred to appropriate agencies or programs and the availability of services could be advertised.

A major issue discussed by this Subcommittee concerns what has been called "equal access to justice." The 96th Congress passed the federal Equal Access to Justice Act, with an effective date of October 1, 1981. This Act requires the federal government to pay court costs and attorney's fees to certain small businesses that are successful in civil action or administrative action brought against them by the government. Kentucky presently has a statute (KRS 453.010) that allows a judge to award costs to individuals successful in civil action involving the state. Proponents of a more comprehensive legislation contend that this statute is rarely, if ever, applied and that it does not include administrative proceedings. They claim that small businesses often pay unjust fines and penalties to state agencies because the businessmen perceive that payment is less costly than challenging the government in court. Critics contend that more inclusive legislation would create a financial hardship by requiring unsuccessful agencies to assume the costs from existing budget. They further claim that enforcement agencies might tend to become lax in their duties because of such legislation.

The Subcommittee on Management and Technical Assistance recommended that the Full Task Force prefile 82 BR 115, which would require a mandatory award to the individual in any civil action that the Commonwealth loses. However, the draft was recommitted to the Subcommittee so that objections raised by executive agencies could be considered. The Subcommittee is now considering adopting certain qualifying language contained in an Arizona Equal Access to Justice Act.

Several states have established a central location in state government to receive all necessary permits for starting a business. Supporters claim that such centralization streamlines the permit process and relieves new entrepreneurs from having to deal with many different departments. Kentucky is presently involved in establishing a pilot one-stop permitting program in the Department for Natural Resources and Environmental Protection. The Subcommittee is presently monitoring the pilot program to determine if legislation is needed to facilitate implementation.

Regulatory Reform. Within the last several years the federal government has taken steps to develop a sensitivity to small business concerns. These steps are aimed at reducing the regulatory and paperwork burdens facing small businesses. The Subcommittee on Regulatory Reform has been studying the feasibility of using the Federal Regulatory Flexibility Act of 1980 as a guideline for state legislation. The following is a brief discussion of major regulatory reform issues the Subcommittee has examined.

Regulatory requirements that are imposed without reference to the size and nature of the businesses being regulated tend to have a disproportionate effect on small businesses and may threaten their ability to compete. Tiering is a way of making the burdens of regulation more equitable without compromising regulatory goals and objectives. Tiering is the tailoring of regulatory requirements to the particular circumstances of individual regulated entities. The Subcommittee is considering the possibility of allowing Kentucky agencies the flexibility to tier regulations.

"Sunset" legislation, enacted in a number of states, applies to phasing out certain regulatory statutes and agencies. It has been noted, however, that most regulatory problems stem not from the statutes but from regulations promulgated by agencies to administer the statutes. For this reason, the Subcommittee is considering "sunset" legislation which would establish a schedule for the periodic review of all regulations. Such review would determine whether individual regulations should be kept intact, revised, or repealed.

A frequently heard comment from small business people is that state agencies are insensitive to the costs a business incurs in complying with a regulation. This observation raises the question in many instances of whether the benefits derived from the regulation outweigh the costs. The Subcommittee is reviewing a proposal to require an agency to prepare and submit a "regulatory impact analysis" as part of the promulgation process. Regulatory impact analysis is defined as a written estimate of the costs and savings of the regulation for the first year following its implementation, as well as the annual costs and savings thereafter. The regulatory impact analysis would include, but not be limited to, the costs and savings of compliance by the regulated entities; the costs and savings of the agency for implementation and administration of the regulation; and the costs and benefits of any alternative methods of accomplishing the goals and objectives of the regulation.

A final issue in regulatory reform is public participation. Small business people complain that those affected do not have sufficient input in the drafting of regulations, and that often regulations are in effect before the business community finds out about them. Provisions for public participation are included in current law governing administrative regulations but the Subcommittee is studying possible ways of improving the process, including the following: (1) Requiring promulgating agencies to make more aggressive efforts to notify, and involve individuals, businesses and local governments affected by a regulation; (2) Extending the time period during which comments can be made and a public hearing requested, and; (3) Requiring that notice of regulations be carried in trade publications.

Cities

REORGANIZATION OF LOUISVILLE AND JEFFERSON COUNTY GOVERNMENT

Prepared by J. David Morris

Issue

Should legislation be enacted to permit the reorganization of local governments within Jefferson County?

Background

Jefferson County is seen by many of its civic and business leaders to be a community in trouble. The City of Louisville, the state's only city of the first class, and the urban core of Jefferson County, is seen to be in a particularly precarious economic condition. Since the 1950s Louisville has suffered a dramatic loss of its population to areas of Jefferson County outside the city. In 1940, nine of ten residents of Jefferson County lived within the City of Louisville; today less than half do so. As the population has moved, so has industry and business, eroding the tax base of the city, at a time when Louisville, like so many aging urban areas, is faced with rapidly escalating costs. The rest of Jefferson County has languished as well. The 1980 census revealed that the population of the entire county decreased since 1970, while neighboring Oldham and Bullitt Counties were the two fastest growing counties in the state. Population projections prepared by the Urban Studies Center predict that Louisville will continue to lose population during the next five years, although Jefferson County will reverse its loss and gain population, but at a rate less than predicted for the state as a whole.

The causes of Jefferson County's and Louisville's problems are numerous and not at all unique, for they are shared by older urban areas across the country. Civic and governmental leaders are trying to combat these problems and reverse the trend toward decline. Many feel, however, that they are handicapped in these revitalization efforts by the existing governmental structure within the county. Jefferson County contains 88 local government units, whose jurisdictions make a crazy-quilt of the county. There is the City of Louisville, a city of the first class, five cities of the fourth class, thirteen cities of the fifth class and 68 cities of the sixth class. On top of that is the county government. Scattered helter-skelter among these full service governmental units are an abundance of "special districts," providing a variety of limited services, such as fire protection or sewage treatment. The effect of this plethora of governments was best described in a 1975 LRC publication:

> Thus, a complex system of local government, which contains more than 140 independent and semi-independent governmental bodies, performing general and single purpose functions, has developed in Jefferson County. Geographically, the numerous political boundaries frequently overlap so that one area may be affected by the actions of several local governments. Moreover, the political boundaries arbitrarily divide the county, fragmenting the resources and loyalities of the interdependent metropolitan area. Functionally, some services are provided by two or more governments, thereby

creating a duplication of services that invites inefficiency and waste.

While no one can point to Jefferson County's governmental problems as the cause of its economic ills, it does not escape notice that Lexington-Fayette County, an urban-county government which formed in 1972, is the fourth fastest growing metropolitan area in the U. S.

The exact issue before the General Assembly is not what form any reorganized Jefferson County government would take or even whether it would be a good idea to reorganize. Instead the issue is whether Louisville and Jefferson County should be given the right to consider reorganization as an option. Jefferson County is currently the only county in the Commonwealth which is excluded from the statutory permission to reorganize local government.

Discussion

The reorganization of government in Jefferson County has been proposed in various fashions since 1955. No matter how it has been presented, no proposal to date has been able to gain widespread acceptance. In recent years, the effort has been merely to get legislation enacted which would permit the creation of a commission to draft a plan, which would then have to be approved by the voters of the county to become effective. This is a privilege permitted every county in Kentucky but Jefferson. The community, however, is so split on the issue that it has been impossible to enact such a bare enabling statute.

The proponents of reorganization argue that the need for reorganization is obvious, given the declining fortunes of Jefferson County. It is felt that the current structure discourages the cooperation which is necessary if the community is to thrive. Specifically, the existence of two competing governments of roughly equal size is seen as wasteful, redundant, unnecessarily expensive, and confusing to those who need to deal with local government. The existence of the multitude of smaller governments only amplifies confusion and waste.

The opposition to reorganization is a coalition made up of various groups who believe such an action would hurt their interests. A major group is composed of the small cities who fear that the existence of a large united government would necessarily lead to their extinction. They argue that the small cities provide better services at lower cost to their residents than could a united government and that reorganization would therefore be against their best interests.

Another group opposed to reorganization is composed of residents who live outside of Louisville who feel that reorganization will lead only to higher taxes with no corresponding increase in services. It is felt by many that Louisville is seeking reorganization for the purpose of having the county residents "bail it out" after years of mismanagement.

Minority groups within the City of Louisville, while not as vocal as the previous two groups, have expressed misgivings about any reorganization. As the legislative body in Louisville is currently elected, Blacks have a significant presence on the board. It is feared, however, that their representation would be significantly reduced on a legislative body elected county-wide.

Finally, there is a mixed group, some for and some against reorganization, who argue that the actual merits of reorganization should be put off to the time when a plan of reorganization is actually presented. They advocate permitting Jefferson County the opportunity to have a body, duly representative of the residents of Jefferson County, draw up a plan which will be put to a vote of the people for approval.

ANNEXATION

Prepared by Ken Fern, Jr.

Issues

Has Kentucky's new annexation law (KRS Chapter 81A) effectively solved the problems which it was designed to address or has it merely created new difficulties?

Background

House Bill 20, enacted by the 1980 General Assembly, was a compromise bill in which competing city and county forces attempted to reach agreement on the issue of municipal annexation. Prior to its passage, the six classifications of Kentucky cities were treated by separate annexation statutes. The provisions of the old laws enabled property owners in unincorporated territories to protest annexation by a city, but the resulting controversy was assigned to the courts for resolution. Judicial determination turned on the issue of whether the proposed boundary change would result in "manifest injury" to annexed property owners if approved, or would "retard the prosperity" of a city if denied. In general, it was felt that this court-determination procedure favored the interests of cities at the expense of unincorporated territories.

For several years, residents of some areas of the state have strongly contended that affected property owners should be given the right to vote on the question of whether to be annexed by a city. With the passage of HB 20, this right was granted. Specifically, the new annexation statutes provide that once a city - other than a city of the first class - has initiated annexation proceedings, a petition of 50% of the residents or property owners in the territory to be annexed can place the issue on the ballot at the next regular election. Seventy-five percent of the registered voters in the territory must then vote against the measure to defeat it. Some city officials felt that the new law would be the death knell for annexation of additional territory, because they believed voters and property owners in areas proposed to be annexed would consistently oppose annexation on the basis of the potential for increased taxes in annexed areas. Conversely, some property owners felt that HB 20 would give cities free reign in enlarging their boundaries, because of the high percentage of "no" votes necessary to defeat annexation.

Discussion

The Local Government Annexation Statute Revision Commission - established by HB 20 - was assigned the tasks of monitoring the implementation and effectiveness of the new annexation law and submitting recommendations and suggested legislation to the 1982 General Assembly. In fulfilling this assignment, the Commission has conducted a statewide survey of Kentucky cities and has determined, in part, that at this time HB 20 has proved to be neither the cure-all nor the evil that was originally anticipated. A very small percentage of survey respondents voiced a strong negative reaction to the new legislation, and only a slightly larger number of cities expressed a totally positive reaction. The majority of Kentucky cities indicated that they have no reaction to HB 20 at this point. Through a series of public hearings, however, the Commission found that the sentiments both for and against annexation in general, and HB 20 in particular, remain quite pronounced in some areas of the state.

There is some feeling that the Commonwealth's old annexation law (KRS Chapter 81) should be re-enacted and that HB 20 should be repealed. This view, coming from the cities rather than the counties, may lend some credence to the sentiment that the previous court-determination method of annexation did indeed favor municipal interests. In view of Kentucky's new municipal code and the home rule powers granted cities by the 1980 General Assembly, however, a re-enactment of the former annexation statutes would perhaps be an untimely reversion to class legislation. In addition, the repeal of HB 20 would destroy its one feature which both city and county officials deem a positive change: the "streamlining" and simplification of annexation law which was effected by the bill. The ability to avoid the extensive and costly litigation over municipal boundary changes that results from complex statutory procedures is a demand of both those in favor of and those opposed to annexation.

Any effort to alter the provisions of HB 20 in 1982 will likely be based on the referendum requirement. Even those who agree that annexation is a purely political issue and should appropriately be decided at the polls are dissatisfied with the specific requirements for conducting an annexation referendum. One line of thinking is that in a true democratic process a simple majority of those voting - as opposed to 75% of those registered - should rule the day. Others feel that residents of both the city and the territory to be annexed should be given a vote - particularly when the annexation of incorporated territory is involved. A third view is that the present law disenfranchises absentee property owners and over-emphasizes the voice of transient residents in areas to be annexed.

Amendment, rather than repeal, should prove to be a more workable approach to these grievances. Similarly, the municipal forces that would do away with the annexation of parts of cities and, further, include cities of the first class under the referendum provision, could do so by amendment. Any substantive changes of this nature, however, jeopardize the compromises embodied in HB 20 and may reactivate all of the old arguments that were at the root of the new law in the first place.

There is some feeling that it is perhaps premature to evaluate the impact of HB 20 at this time and that the Annexation Commission should take a wait-and-see attitude in its recommendations for 1982. This sentiment stems from the fact that many municipal annexation disputes will remain pending until November of this year because that date will be "the next regular election" at which the issue can be decided. In some areas of the state, it may be true that the anticipation of the new law will ultimately prove worse than its implementation and until a greater number of Kentucky cities have attempted annexation under HB 20, the retention of its provisions may be the most plausible course of action for the 1982 legislature.

FISCAL NOTES

Prepared by Jamie Jo Franklin

Issue

Should the Kentucky General Assembly be required to prepare "fiscal notes" for state mandates relating to local governments?

Background

Kentucky's local governments are caught in a tightening fiscal squeeze by forces over which individual cities and counties feel they have little or no control.

The costs of maintaining current service levels is constantly being driven up by inflation, while at the same time, cities, counties and special districts are being hard pressed to supply new customers and expand levels of service. The ability of cities to rely on property tax to fund these services is also faltering. Municipal authorities are finding it increasingly difficult for ad valorem tax revenues to keep pace with increasing costs, due to tax constraints from constitutional, legislative or local restrictions. These problems, compounded by the elimination of large sums of federal aid, have caused closer scrutiny than ever before of every expended local government dollar.

Local budget-making has in many ways become a reactive process tied to the availability of monies from intergovernmental transfers and the regulatory directives of state and federal mandates. In 1960, intergovernmental transfers (revenue sharing, federal grants-in-aid, state aid, etc.) accounted for only about 10% of local government expenditures. Moreover, most of these were considered to be non-recurring capital expenditures, such as funding a public building or some other large construction project. But by 1978, intergovernmental transfers accounted for more than 30% of all local government expenditures, and in some instances exceeded 50%. And, by contrast with the 1960 figures, more of the transfers were being used to fund the day-to-day operational costs of local governments. Mandates, which are legislation and administrative regulations which require or result in the expenditure or reduction of local revenues, are often issued to achieve more uniform levels of service or to provide the public with guarantees of accountability and other legitimate objectives (e.g., forms of local government, election laws). On the darker side, mandates can fall victim to serious abuse as the result of pressure from interest groups out to get a larger share of local expenditures. Also, failure to follow mandates with corresponding funding often results in a reallocation of funds from local priorities.

During the 1980 General Assembly legislation was introduced to address the state/local mandates problem. But HB 81, which would have required the preparation of fiscal notes for all legislation and regulations relating to local governments, failed to pass. However, when considering the procedure and the information necessary for fiscal note preparation, it was recognized that fiscal notes could not be realistically calculated without the existence of reliable and comparable information about local revenues, expenditures and debt. While detailed information regarding counties already existed at the state level, little or nothing was known about the finances of Kentucky's cities. SB 18 and 26, enacted to deal with municipal accounting and reporting procedures and standards, addressed this need. With the passage of this "municipal code" legislation, certain raw elements of reliable and comparable information on local fiscal conditions became available. Such data now makes possible the development of reliable techniques for the measurement of the fiscal impact of state mandates on local governments.

Discussion

Given the current fiscal condition facing many local governments and the fiscal relationship between local government expenditures and state regulations, the 1982 General Assembly will probably be presented with legislation proposing some identification or control of state mandates. While fiscal note preparation is seen as an initial step in addressing state mandates, it can by no means be thought of as the only available option.

The strictest control of state mandates would be their prohibition, but this is seen as a very radical step with deep-seated political overtones. Also, legislation of this type could be easily overturned by any subsequent legislature. So for any prohibitive legislation to have any real "teeth," it would most surely have to come in the form of a constitutional amendment.

Another restraining mechanism would be a reimbursement, in whole or in part, to local governments for state mandates. But given current state finances, the possibility of any new expenditures of state funds is unlikely.

The third and seemingly most desirable alternative for dealing with state mandates is the preparation and attachment of fiscal notes for any proposed legislation or administrative regulations affecting local governments. Such notes would offer "ballpark" estimates of the fiscal impact of such mandates on local governments. While a fiscal note procedure would not directly limit state mandates, it would mean that the fiscal relationship between the Commonwealth and its local subdivisions would no longer be left to chance or the pressures of immediate crisis situations. Fiscal notes, by establishing the fiscal impact of state mandates, would enable the General Assembly to review regulatory proposals and their economic feasibility. The "price tagging" of mandates would in turn promote a more rational decision-making process, by making public officials more aware of the possible financial burdens under which local governments may be placed.

OTHER ISSUES RELATING TO CITIES

Property Assessment Moratoria to Encourage Rehabilitation

Issue

Should cities be authorized to grant property assessment moratoria as an inducement for the rehabilitation of dilapidated buildings?

Background

The 1980 Session of the General Assembly enacted a proposed amendment to the Constitution (80 HB 109) which will enable local governments to offer property tax abatement to encourage rehabilitation of property. The proposed amendment will be on the ballot for voter approval at the November 1981 regular election. If approved, the new constitutional provision (hereinafter Section 172B) will need enabling legislation. The amendment is being proposed so that local governments will have the ability to offer tax breaks to individuals or businesses to encourage them to rehabilitate real property. The provisions of Section 172B are simple. Local governments will be allowed to declare property assessment or reassessment moratoria on qualified property for up to five years. The reasoning behind the amendment is equally simple. The rehabilitation of property which is in dilapidated condition greatly increases the value of that property. Under current law local governments must tax all real property, unless exempted, at full fair market value. Thus there exists in the current tax structure a disincentive for the restoration or rehabilitation of dilapidated real property, because an owner's efforts to "fix up" his property often results in a significantly higher tax bill. The proposed amendment recognizes that many local governments are willing to forego short-term tax revenues for the promise of a long-term improvement of the tax base.

The exact mechanics of any enabling legislation are as follows. A local government would enact legislation setting out the standards and qualifications necessary to apply for tax abatement treatment. Persons then granted the privilege of tax abatement would rehabilitate their properties, and the consequent increase in value or a percentage thereof, would not be picked up in a new assessment for a certain period, not to exceed five years. At the end of the moratorium period the property would be reassessed and placed on the tax rolls at its full value.

Municipal Legal Liability

Issue

Should the General Assembly legislatively shield cities from or cushion the impact of judgments resulting from tortious acts?

Background

Until 1964 cities in Kentucky were immune from tort liability for most actions. The courts have stripped away that protection, but have since failed to develop a consistent standard regarding liability. The unpredictability of decisions on municipal liability cases has caused cities concern, because it makes risk management very difficult and uncertain. Cities are called upon to perform a wider variety of services than ever before, many of which involve activities with high risk. The inability to predict the potential liability associated with such activities discourages some cities from performing needed services. Additionally, because of their precarious financial condition, many cities risk bankruptcy if faced with a large adverse judgment.

The General Assembly could inject order into the area of municipal liability by legislatively defining when and for what cities will be liable, thereby removing the issue from the judgment of the courts. Another option might be to mandate cities to carry liability insurance or facilitate the ability of cities to form insurance pools in order to cushion the impact of liability.

Enterprise Zones

Issue

Should Kentucky involve itself with "Enterprise Zone" legislation, either through federal programs, if enacted, or by devising its own program at the state level?

Background

The proposed federal "Urban Jobs and Enterprise Zone Act" provides incentives for establishment of small business and industry in impoverished neighborhoods, or "zones," within participating urban areas. The provision of these incentives would be directly tied to the creation of new jobs for residents of the designated zones. To participate, state governments would designate "enterprise zones" within their boundaries by means of a formal application to the Secretary of Housing and Urban Development. Applications would be reviewed against a series of specific poverty and unemployment criteria, which are enumerated in the proposed legislation.

Some of the federal standards for acceptance of an area for "zone" status suggest that the program's applicability would be minimal outside of major population centers. At least two states have introduced their own "Enterprise Zone" Acts, both of which assign the administration of the program to existing departments of commerce within their respective state governments. By permitting local governments to style the standards for "zone" acceptance to their own particular needs, legislation at the state level may be the only means by which the less populous areas of the country may participate in the program.

Counties and Special Districts

COUNTY JAILS

Prepared by Prentice Harvey

Issue

What Action Should the General Assembly Take to Improve Kentucky's System of County Jails?

Background

Most of Kentucky's county jails fall short, in one respect or another, of minimal standards imposed by the U. S. Constitution. Two basic factors underlie the shortcomings of county jails in this state - the age of many of our jails and inadequate funding of jail operations. Many jails are simply too old. Originally built to meet standards of years gone by and having deteriorated with age, many jails do not meet contemporary fire safety regulations, health codes or laws relating to conditions for the confinement of prisoners.

Aside from the physical condition of the jails, operating expenses in a number of counties are not being adequately met by combined state and county funds. Consequently, many jails are seriously understaffed and lack such essential programs as basic medical care.

Our constitutional system of electing jailers also contributes to our present problems and makes change difficult. The constitution requires that a jailer be elected in each of Kentucky's one hundred and twenty counties, unless the general assembly consolidates the offices of jailer and sheriff. Though the assumption is presently under legal challenge, this election requirement has long been interpreted to mean that each county must operate a jail. Given the size and small population of many Kentucky counties, operation of a full-service, independent jail is economically burdensome, especially in view of the high standards now used to evaluate jails.

Pressure for some action on the jails question comes from several sources. Many county officials would like to be rid of jail responsibilities. They thought they would lose these responsibilities when the judicial authority of county officials was eliminated, especially since county court revenues had been used in many cases to support the jails. But the judicial article did not direct the state to assume control of or responsibility for the jails. Despite the fact that the state has assumed the greatest part of the responsibility for dieting fees (1976), and has also begun to pay for emergency medical care for indigent prisoners (1979), many counties feel they cannot afford to maintain or improve their jails.

Some concern has arisen from changing thought about what jails should be like and how prisoners should be treated. Furthermore, what changes conscience does not dictate may well be mandated by the federal courts. In short, the United States Constitution, as interpreted by the federal courts, guarantees certain minimal jail standards. In many states, jail conditions and the treatment of prisoners have been the focus of civil rights suits under

42 USC 1983 in the federal courts. The precedents are well established, and many Kentucky jails are ripe for suits that could be devastating for local officials and for county budgets. Depending on the nature of the suit, liability for damages and attorney fees in these suits could fall on the county officials personally or the county treasury. Alternately, a federal court might order reform of jail conditions and specify in great detail how the jail must be run. Regardless of one's personal opinion about jail conditions and treatment of prisoners, it is important to recognize that many counties are extremely vulnerable to costly law suits.

Discussion

An adequate solution to problems confronting county jails must deal with questions of jail construction and renovation, adequate standards and funding for jail operation, medical care for prisoners, staffing of jails, and training of jailers and deputies. Necessary improvement will likely be costly and will take years to fully implement. Yet if the state is to help minimize the potential legal liability of its counties and their public officials, it must make a beginning toward solving this multi-faceted problem. Although the two are related, one might conceive of two approaches to solving county jail problems. The first would be in terms of operations and programs, and the second, bricks and mortar. Operations and programs would include setting adequate standards, providing trained staff, maintaining existing facilities, developing work-release programs, conforming to health standards and providing proper diet and medical care for prisoners. "Bricks and Mortar" would include developing a plan for how many jails are needed in Kentucky, including location and source of revenue, and then building them. Operations and programs can be improved more rapidly than jails can be constructed or renovated, unless financial resources are unlimited. But adequate operations and programs depend in many ways upon having adequate physical facilities. In the long run, both operations and physical facilities must be improved.

There is presently no agency of state or local government in Kentucky that has comprehensive authority to set standards for operations and programs in jails. The state fire marshal exercises authority for fire safety. The Department for Human Resources sets standards relating to health and comfort. The Department of Corrections offers inspection and training services on a good will basis, but exercises no statutory authority other than approving construction plans. There is no statutory mechanism to integrate the activities of the Fire Marshal, the Department for Human Resources and the Department of Corrections. At the county level, the county judge/executive must inspect the jail, and the fiscal court must set standards for "government and cleanliness" of the jail and the comfort and treatment of prisoners. But the fiscal court has no direct authority over the jailer, and furthermore it is not reasonable to expect the fiscal court to set standards that it does not have the financial resources to implement.

It would seem that the first step in improving operations and programs in jails would be to give one agency of state government the authority to set standards, and to give it the financial resources to implement those standards, with the cooperation of the independently elected jailers. These standards could encompass the three areas now covered by the Fire Marshal, the Department for Human Resources, and the Department of Corrections. Money would be required for an adequate schedule of inspections, and to provide training to jailers and their deputies. Jailers, unlike sheriffs and county clerks, do not receive an expense allowance. Perhaps an expense allowance paid upon good faith efforts to meet standards set by the designated state agency would provide needed incentives.

A second step toward jail improvement would be the planned relating of operations and programs to bricks and mortar. Presently there is no constitutional requirement that a county have a jail. The only requirement is that a jailer be elected. Nor do the statutes explicitly state that a county must have a jail. That question is now being tested in the court system. The courts can determine what the law presently requires, but the courts cannot develop a comprehensive plan for developing an adequate system of jails. That is not their function. It is within the legislative authority to address the question of whether each county must have a jail, or whether there shall be a system of district or regional jails. If each county must have a jail, then revenue sources must be found to fund that alternative. If each county will not be required to have a jail, then an agency must be vested with responsibility to determine how many jails there will be, where they will be, and when they will be constructed. The legislature can create the mechanism or agency to plan a system of jails, should it decide that each county does not need to maintain a jail.

Discussion of jails always leads to questions of where the money for construction will come from. Presently the operation of jails is funded by state-provided dieting and medical fees, court costs levied in district court, and fiscal court appropriations. When new jails are constructed they are frequently financed to some degree by federal grants. While the state provides millions of dollars annually for the operation of jails, operational responsibilities lie with the jailer and the fiscal court.

In the future, jails could become the total responsibility of state government or they could remain a local responsibility with state assistance. It is not likely that they would be an entirely local responsibility with 100% local funding - for two reasons. Counties would have difficulty funding jails on their own, and the corrections profession at the local level needs the standards, training and technical assistance which the state can provide. Because the jailer is a constitutional, elected county official, it is likely that jails, as part of the total corrections system in Kentucky, will remain an area of county and state cooperation. Both counties and the state can contribute to new jail construction through the issuance of tax exempt bonds, and through the use of federal grants. The extent and pace of new construction depends upon the plans which are adopted, and the urgency attached to those plans.

LAW ENFORCEMENT AND PROFESSIONAL FIREFIGHTERS' FOUNDATION FUNDS

Prepared by Gordon F. Mullins

Issue

Should state government supplement the wages of local police officers and professional firefighters?

Background

State government currently supplements the wages of over three thousand local police officers under the Kentucky Law Enforcement Foundation Program Fund (KRS 15.410-.510), at the rate of 12 1/2% of each eligible recipient's annual salary. Over twenty-four hundred of the state's local professional firefighters (paid, full-time personnel) currently receive state wage supplements, at the rate of 5% of each recipient's annual salary, under the Kentucky Professional Firefighters' Foundation Program Fund (KRS 95A.200-.300). Each program fund is financed from the state general fund.

Initially, the maximum rate of assistance provided under each program was 15% of each recipient's annual wages. But, due to increased earnings of recipients, the rates of assistance have been reduced to correspond to the allotment of funds to each program. As a result of these reductions, local police officers and firefighters, as well as local public officials, have expressed concern about the losses in income to eligible recipients. City and county officials fear that any further cutbacks in funding may create significant labor problems for their governments.

In 1980, the Legislative Research Commission created a Task Force on Law Enforcement and Professional Firefighters' Foundation Funds to study the issues surrounding both programs and to recommend funding alternatives. The Task Force has recommended continuation of both programs, with a flat rate of $2,500 annually per recipient, to be increased 5% annually after the second year. In lieu of continued state general fund support (a total of over $8 million for FY 82), the Task Force has recommended that the state insurance premium tax be increased from 2% to 3 1/2%, with the proceeds from this tax increase earmarked for these programs. State general fund support is recommended during the first year until tax proceeds are available.

Discussion

The difference in current costs (based on a percentage rate of assistance) and the amount needed to pay all recipients based on the flat rate is $5 million for FY 83. A flat rate has distinct advantages over the percentage rate in that a flat rate would be: 1) easier to administer and to budget; 2) less costly to the state, since appropriations need not necessarily increase with earnings; and 3) a greater inducement to younger, less experienced personnel to stay in law enforcement or firefighting. Conversely, these factors are the major disadvantages of the current percentage rate of assistance.

Regarding funding alternatives, the Task Force stated in its report that the insurance premium tax alternative is justified, because better law enforcement and fire protection should benefit insurance companies, by helping them reduce insurance losses. The proposed tax increase would provide sufficient funds to support both programs. A negative aspect of this alternative is that the tax increase may eventually be passed on to the consumer.

OTHER ISSUES RELATING TO COUNTIES AND SPECIAL DISTRICTS

Local Planning and Zoning

Issue

Should the General Assembly amend KRS Chapter 100, restructuring local planning units and planning commissions, and provide for greater public involvement in local land use decisions?

Background

LRC Research Report No. 134 was issued in July, 1977. Recommendations of that report strongly suggest that the structures of local planning units and commissions are perplexing to many citizens, who are often angered that zoning decisions are reached without regard to neighborhood interests and customs. The issue is whether the structure of planning units and commissions authorized under KRS Chapter 100 should be changed by the General Assembly, to afford greater citizens' participation in zoning and related land use matters. Several approaches could be taken, including decentralization of planning commissions in highly urban areas, and requiring decentralization of hearings whenever those residing on or owning property adjacent to, or in close proximity, to property whose zoning classification is proposed to be changed, request the hearing on the proposed change to take place within the neighborhood to be affected. Another approach would be to require, by state law, neighborhood plans before any further zone changes are made, and require the approval of persons residing or owning property in a neighborhood affected.

Investment Opportunities for County Governments

Issue

Should county fee officers and fiscal courts be allowed to invest idle dollars for public benefit, including voluntary pooling of funds?

Background

County governments are being financially squeezed for two basic reasons. Tax resources are limited, and the prices of goods and services are increasing. Because of strong resistance to tax increases by citizens and tax increase limitations imposed by the General Assembly, it is necessary to get more out of available dollars if service demands are to be met. Investment of public funds prior to expenditure increases the amount of available public funds with no increase in taxes.

Management of funds at the county government level is somewhat fragmented, due to the constitutional structure of county government. County clerks, as well as fiscal courts, frequently have idle dollars on hand. Sheriffs, who disburse tax dollars to taxing jurisdictions only once a month, usually have the greatest sums. If all available idle dollars are to be invested, fee officers must be included in investment programs. Current law does not give county fee officers authority to invest, however, though some do so to the benefit of their counties. Fiscal courts are presently permitted to invest, but there is no statutory mechanism to permit the pooling of funds by counties, other than by the cumbersome method of interlocal agreements.

Pooling of funds for investment purposes would be of benefit to small counties with limited funds, because larger sums earn higher returns. Pooling also permits investments for shorter time periods than individual investments. So long as invested public funds are properly insured and attention is given to cash flow needs, it is difficult to find arguments against investing.

Elected County Official Pensions

Issue

Should pension benefits be raised for elected county officials?

Background

Presently, elected county officials, who are members of the County Employes Retirement System, are governed by the same pension formula as county and state employees: 1.6% of average salary for each year of service. In the past, county officials have discussed the possibility of raising the formula to 2.0% of average salary per year. Such discussions have not led to formal requests because of consideration of the impact of pension benefit increases on other public employee pension systems. During the 1980 Session, legislators' retirement benefits were raised from 1.6% to 3.5% of average salary for each year of service. In light of this action, county officials probably will seek either a special formula within CERS, or the establishment of their own retirement plan with increased benefits. Increased costs for county official benefits would fall upon county governments. Any action taken to benefit county officials will probably be followed by requests for increased pension benefits from other public officials and employee groups, and significant pension cost increases for the state could follow.

OTHER ISSUES RELATING TO COUNTIES AND SPECIAL DISTRICTS

Medical Care for Indigent Prisoners in County Jails-1

Issue

Should the Commonwealth of Kentucky adopt broad policy standards for medical care to ensure the protection of the constitutional rights of inmates in county jails?

Background

Persons detained in jails, prisons and other confinement facilities retain basic rights guaranteed by the United States Constitution and protected by Section 1983 of the Civil Rights Act of 1871 and the Civil Rights for Institutionalized Persons Act of 1980. Significant among the legal rights retained by inmates is the right to adequate medical care.

In Estelle v. Gamble, 429 U.S. 97 (1976), the United States Supreme Court acknowledged a governmental obligation to provide essential medical care to those being punished by incarceration. This court reasoned that failure to do so causes pain and suffering which amounts to cruel and unusual punishment, a violation of the Eighth Amendment. The federal court has also ruled that failure of an institution to maintain adequate medical plans and facilities is equally a violation of the Eighth Amendment.

Several standards for medical care have been established by various federal court decisions. The United States Justice Department and various national organizations have adopted comprehensive sets of jail standards consistent with the minimum constitutional standards delineated by the federal courts. The Justice Department standards are used to evaluate federal, state, and local correctional systems, and to guide the department in litigation against facilities charged with violation of an inmate's constitutional rights.

Medical Care for Indigent Prisoners in County Jails - 2

Issue

Should the type and extent of medical care expenses authorized for payment in local jails be clarified?

Background

The type and extent of medical care expenses for indigent county jail prisoners is not adequately defined in KRS 441.010. The current statute seems to imply that some degree of emergency need must exist. However, authorizing payment of the initial diagnosis has resulted in payment of all medical expenses, including routine jail sick calls. Statutory change is needed either to define more clearly the medical expenses covered or to restrict use of the initial diagnosis clause.

Method of Paying Expenses for Indigent County Prisoner Medical Care

Issue

Should statutes authorizing payment of indigent jail inmate medical expenses be amended to permit the payment of a proportion of contract medical services?

Background

The current statute, KRS 441.010, provides for payment of expenses on a per occurrence basis, which is not compatible with a contract medical care approach used by some jails. This approach has resulted in avoidance of the program or the elimination of contract services. Expanding coverage to permit a proportional payment of contract services could encourage the adoption of better medical care approaches.

Investment of Tax and Fee Collections

Issue

Sheriffs are not permitted to invest taxes and fees collected for the benefit of the county.

Background

Sheriffs handle large sums of money and are compelled to hold these funds idle for significant periods of time. Tax and fee collections, even if held only an average of twenty days, could earn significant amounts of interest for counties.

Education

PUBLIC SCHOOL FINANCE

Prepared by Janie L. Jones

Issue

Should the restrictions that HB 44 placed on the local school district's ability to generate revenue with the property tax be amended or repealed?

Background

Prior to the passage of HB 44, local taxing authorities were allowed to apply a fixed tax rate to increasing property values, resulting in significant increases in property tax bills. HB 44 restricts the amount of increase on existing property, without a vote of the people, to 4% annually. A rate which will generate more than a 4% increase can be levied, subject to recall, following a public hearing. The restrictions imposed by HB 44 grew out of the taxpayers' concern with increasingly larger tax bills. On the other hand, reductions in the amount of state support for education means that local support must be increased if the current financial base is to be maintained. Although the state has been providing more than 70% of the total funding for education, the property tax has remained the major source of local support.

Discussion

Although HB 44 placed a cap on the total amount of property tax that can be collected, a number of districts have not taken advantage of the flexibility that is built into the law. While many districts complained that the restrictions are causing financial difficulties, forty-one districts (23%) did not take the allowed 4% increase in 1980-81 revenue over the previous year. Perhaps even more significant is the fact that under HB 44 an increase greater than 4% may be levied if a majority of the voters in the district approve.

If the 1982 General Assembly wishes to change the limits imposed by HB 44, a number of alternatives exist, including the following:

(1) Remove the cap on the amount of revenue that can be collected, with a provision for recall any time the rate produces more revenue than was produced the previous year.

(2) Establish a fixed rate of increase that is higher than the current 4% rate.

(3) Establish a variable rate of change that increases or decreases according to some identified economic indicator, such as an average cost of living index.

OTHER ISSUES RELATING TO EDUCATION

Continuity of Education Governing Boards

Issue

Should the Council on Higher Education and the State Board of Education be exempt from reorganization by executive order, so as to maintain the continuity of membership necessary for effective governance of education?

Background

The Council on Higher Education is established by statute as the governing board for all institutions of higher education, and the State Board of Education, also established by statute, is the governing board for elementary and secondary education.

In July 1980, less than three months after the General Assembly adjourned, both boards were reorganized by executive order and new members appointed. Similar reorganizations have occurred in the past. Although the statutes give the Governor the authority to appoint members, they establish a specific length for terms, with staggered appointments, in order to maintain a continuity of experienced membership on the boards.

KRS 12.025 gives the Governor broad power for reorganization by executive order. That statute could be amended to specifically exempt the Council on Higher Education and the State Board of Education from reorganization by executive order.

Student Fees

Issue

Should the state provide funds for those fees necessary for a student to participate fully in the public school program?

Background

Funding for the furnishing of educational fees for public school students began in the 1976-78 biennium. Over a six-year period, more than $52 million has been allocated for that purpose. During the 1981-82 biennium, the state's revenue shortfall has resulted in a reduction of student fee appropriations of approximately $9 million, leaving a total state expenditure of slightly over $43 million for the six-year period.

When the student fee statute was enacted in 1976, it provided that no fees of any kind could be charged to the student. This provision was amended in 1980 to allow districts to charge students for participation in certain enrichment activities.

A bill has been prefiled by the Interim Joint Committee on Education to completely repeal the statute relating to student fees.

Professional Negotiation for Teachers

Issue

Should the General Assembly enact legislation requiring local boards of education to enter into professional negotiation procedures with teachers?

Background

For more than a decade the issue of professional negotiation rights for teachers has been before the General Assembly. Proponents of the issue have taken different approaches, ranging from permitting school boards to establish mechanisms for teachers' input to mandated negotiation procedures and binding arbitration. At present, Kentucky law does not prohibit negotiations between the board and the teacher representatives if the board initiates the activity. The Kentucky Education Association has long considered professional negotiations to be one of its major legislative issues.

Scientific Creationism

Issue

Should there be legislation to require that scientific creationism be taught in the public schools?

Background

There is a national movement to influence state legislatures to require that scientific creationism be given equal time with the theory of evolution in the public school curriculum. Scientific creationism is the theory that the Earth was created at once by an outside force and has changed little since. There is ongoing debate about the scientific value of the theory and whether its proponents want it included in the curriculum to promote religious views or to provide students with a diversity of ideas.

Kentucky statutes allow but do not require the theory of creation, as presented in the Bible, to be discussed whenever the theory of evolution is taught.

Elections and Constitutional Amendments

LOCAL INCOME AND SALES TAXATION

Prepared by Robert S. Sherman

Issue

Should the General Assembly propose to amend the Constitution of Kentucky so as to allow the governing bodies of local taxing districts to invoke local income or sales taxation, in lieu of ad valorem taxation, for the funding of local governments and school districts?

Background

During the 1980 Regular Session of the Kentucky General Assembly, the House Committee on Elections and Constitutional Amendments received but did not act upon a proposed constitutional amendment (HB 49) that would have allowed local taxing districts to invoke local income taxation, in lieu of all forms of ad valorem taxation, upon referendum approval by local electorate. The idea encompassed within HB 49 indirectly caused the formation of the Subcommittee on Property Tax Alternatives of the 1980-81 Interim Joint Committee on Elections and Constitutional Amendments and it has been incorporated within a bill draft prefiled for consideration by the 1982 General Assembly (82 BR 94).

During the initial stages of its investigation, the Subcommittee received expert testimony that indicated that two alternatives to property taxation were probably the most viable: local sales taxation and local imposition of an income tax. Very rough estimates showed that a local sales tax comprising an additional two and one-half cents per sales dollar would be needed to replace revenue collected through the property tax. Similarly, property tax replacement by a local income tax would require a taxation level of approximately sixty percent of the average state income tax liability. It should be noted that these figures would become relevant only if a plan were utilized which allows local sales or income taxation in lieu of ad valorem taxation by the local taxing entity in question.

In an attempt to gauge opinion of local officials regarding alternatives to the taxation of property, such as local sales or local income taxation, Legislative Research Commission staff prepared and mailed a questionnaire on the subject to a sample group consisting of public school superintendents, county judges/executive, and selected mayors. Of the responses received, thirty-nine percent indicated that taxation of property was not the most appropriate method by which to fund local governments and school districts. The questionnaire showed a lot of disagreement regarding the most appropriate funding tool, however. Of those respondents favoring a property tax alternative, twelve percent favored a local sales tax and an additional twelve percent favored a local income tax. The remaining 76 percent either had other suggestions or had no suggestions.

The Subcommittee on Property Tax Alternatives has additionally heard personal testimony on this subject from local governmental officials, as well as from private citizens and organizations. Most indicated dissatisfaction with present ad valorem taxation at the local level, usually in its operation, sometimes in its mere existence. While it would be an overstatement to suggest that a majority of interested persons at any level of government support local sales or income taxation as an alternative to property taxation, or that such devices are a panacea to revenue problems of local government, it must be said that the issue, at least as an experimental program, will command serious scrutiny by the General Assembly in 1982.

Discussion

As indicated in the statement of this issue, should the General Assembly wish to allow the governing bodies of local taxing districts the opportunity to invoke local sales or income taxation, the proper legislative vehicle would be a proposed constitutional amendment. Section 181 of the Constitution of Kentucky provides the bulk of authority for the various taxation devices utilized currently by local taxing entities. This section does not give local districts general income taxation power. The General Assembly may authorize municipalities to tax personal property based on income, but counties and school districts evidently do not have the constitutional authority to invoke income taxation schemes of the scope and type utilized by the state as a whole. Section 181 also reserves to the General Assembly the authority to invoke special or excise taxes, the latter category encompassing sales taxation.

The proposal in this area gaining the most discussion in the Subcommittee on Property Tax Alternatives is encompassed in prefiled bill 82 BR 94. This proposed constitutional amendment would amend Constitution Section 181 so as to mandate that the General Assembly allow cities, counties, and school districts to invoke local income taxation upon referendum approval of the locally affected electorate. Such a tax in effect would be based upon a percentage of state income tax liability, to be collected by the state and reimbursed to the locality. It is also interesting to note that this proposal would require that local income taxation be in lieu of all other ad valorem and permissive taxation currently allowed a locality by constitutional provision and statute. Although this specific proposal does not include a local sales taxation option, Subcommittee discussion has generated interest in including this alternative as well.

There are particular benefits that would arise should a proposal such as that described above become locally effective. One benefit involves the ease of assessing a local income tax as a percentage of state income tax liability, coupled with an ease of tax collecting should the state collect and rebate funds to the local district. These benefits would be accentuated should a locality be forced to abandon local property taxation upon approval of income taxation. Abandonment of property taxation would also eliminate the persistent problem of inexact, omitted, or fraudulent property assessment, as well as difficulties with delinquent property tax payments.

Taxpayers in a local jurisdiction which has converted to income taxation in lieu of other forms of permissive taxation would receive the beneficial effect of knowing the total amount actually paid for local governmental service, due to a simplified payment of one type of tax rather than a multitude of what might be termed nuisance taxes. It has been asserted that if the General Assembly offered local sales taxation as an additional option for a single tax replacement to current forms of local taxation, benefits similar to those associated with a local income tax plan would be realized.

Giving local governing bodies an alternative tool in their selection of revenue generating devices might also be of benefit in allowing such bodies to fund necessary governmental services and programs more effectively. In other words, a local income or sales taxation plan might be more satisfactory to the electorate of some communities than current ad valorem property taxation and its associated statutory rate limitation and assessment inequities. These communities might realize higher revenue returns by utilizing such alternative revenue plans.

A final appeal of the local sales and income taxation plans currently being discussed is the fact that such programs would only go into effect upon referendum approval of the local electorate. While the governing body of a local district could propose usage of one of these taxation forms, as well as particular rates of taxation, only the taxpayer actually affected could vote the plan into service. Thus, the local governments that would be experimenting with alternate forms of governmental funding would be those in which the experiment clearly received public support, thereby offering a greater chance of success.

A number of possible disadvantages to local sales and income taxation plans should also be mentioned. Many county, municipal, and school taxing district boundaries overlap. Should one division, such as a school district, opt to utilize an alternative taxation form in lieu of ad valorem taxation, while another intersecting district maintains the status quo, confusion to taxpayers could result. Further, even though advocates of local sales and income taxation point to an eventual elimination of reliance at the local level upon property assessments and attendant inequities as a major advantage, it must be remembered that state property taxation would continue to exist and statewide assessments would continue to be a necessity. Additionally, detractors have expressed an abhorrence of the creation of any new taxation form which might eventually be used in combination with present local taxation to further burden taxpayers, or which might be used as a mere device to escape rate limitations statutorily imposed upon the taxation of property.

A disadvantage particularly associated with local income taxation can be cited in regard to corporate income. Although proposals anticipate the taxation of corporate income at the local level, questions could arise concerning the local residence of certain corporations. If, for example, a corporation maintained its main office in an urban area within the state but derived much of its income from business transactions involving residents of other counties, where would taxing situs lie? It would be assumed, however, that such questions could be resolved by legislation implementing a constitutional amendment permitting local income taxation.

A final disadvantage concerning local sales taxation is the possibility of sales tax rates varying between local districts. Differences in rates would result where one jurisdiction enacted a local sales tax and neighboring districts did not, or where neighboring districts enacted rates of differing amounts. It would seem that a higher sales tax rate in a given district might harm local retailers, by causing purchasers to select purchasing locations where lower rates apply.

CONSTITUTIONAL REVISION

Prepared by Linda Wood

Issue

Should the Kentucky Constitution be revised to amend or repeal those sections which have been overruled or substantially modified by court decisions or federal law, which are obsolete, or which are simply not being enforced?

Background

The process for amending, and thus revising, the Kentucky Constitution is very restrictive. Prior to 1979, Section 256 of the Constitution provided that only two constitutional amendments could be placed on the ballot at one time. In November of 1979 the voters approved an amendment to Section 256, which increased to four the number of amendments which can appear on the ballot. The result of such strong limitations upon amending the Constitution has been that there has been, since its 1891 adoption, a gradual accumulation of sections which have been overruled or substantially modified by court decisions or federal law. Other sections have lapsed into obsolescence or are simply no longer being enforced. The General Assembly has understandably used its very restricted allotment of amendments to propose the most urgent changes rather than to pass "cleanup measures."

Section 145 is an example of a constitutional section which has been superseded by federal law. This section establishes voting residency requirements as "in the state one year, and in the county six months, and the precinct in which he offers to vote sixty days." Federal law provides at 42 USCA 1973 aa-1 that there shall not be a durational residency requirement as a precondition to voting for the United States presidency and vice presidency. KRS 116.025, which sets out requirements for eligibility to vote, is in agreement with the federal law and in disagreement with the Kentucky Constitution, by its provision that the voter must possess "the qualifications set forth in constitution section 145, exclusive of the durational residence requirements...."

Section 187 is an example of a section which has been overruled by both federal and state courts. This section states that "separate schools for white and colored children shall be maintained." This provision is unconstitutional in light of the U.S. Supreme Court decision in Brown v. Board of Education, 347 U.S. 483 (1954). Additionally, the court in Willis v. Walker, 136 F. Supp. 177 (1955), specifically held this section unconstitutional.

Sections 91, 93, 94, 95, 228, 239 and 240 serve as examples of sections which are clearly obsolete. Sections 91, 93, 94, and 95 refer to the "Register of the Land Office." This office was abolished by KRS 56.020, which assigned the duties of the Register of the Land Office to the Secretary of State. Provision for the statutory abolishment of the office is included in Section 94. Sections 228, 239 and 240 refer to dueling, a fact of life in a past era for which restrictions are no longer necessary.

The Kentucky Constitution also contains some sections which are not enforced. An example is Section 46, which provides that "Every bill shall be read at length on three different days in each House, but the second and third readings may be dispensed with by a majority of all the members elected to the House in which the bill is pending." In current practice, bills are not read at length even the first time.

Discussion

The Kentucky Constitution provides that a constitutional amendment shall relate to only one subject. The above suggestions for revising the Constitution include sections which have been overruled or substantially modified by court decisions or by federal law, those sections which are clearly obsolete, and those sections which are simply not enforced. These various types of revision can be included in one amendment only if they relate to one subject.

The issue of what constitutes one subject has been challenged in the courts a number of times in Kentucky under the original language of Section 256. Prior to voter approval of a constitutional change in November of 1979, that section provided in part that "no amendment shall relate to more than one subject." The following challenges to the "one subject rule" were made prior to 1979 and thus were governed by the above language of Section 256.

The General Assembly passed an amendment in 1942 which proposed to remove the limit on the salaries of public officers. The amendment was challenged, and it was argued that the effect of the amendment would reach municipal and county governments, and this fact was not stated on the ballot. The Court of Appeals held in Hatcher v. Meredith, 173 S.W. 2d 665 (1943), that "if each provision of a proposed amendment is an integral part of a general plan, the amendment is not plural."

The General Assembly passed an amendment in 1950 which proposed to increase from two to five the number of constitutional amendments which could be submitted to the voters. The amendment was challenged, and it was argued that since the amendment proposed to first repeal a section and then to enact a section, it covered more than one subject. The Court held in Funk v. Fielder, 243 S.W. 2d 474 (1951), that an amendment may cover several propositions if they are not distinct or essentially unrelated. The Court further stated that the question of whether an amendment related to more than one subject was a matter for the General Assembly to decide when proposing an amendment.

The constitutional debates of 1889-91 indicate that an amendment to "one subject" of the Constitution could be an amendment to an entire Article. An example of this is the Judicial Article, which was passed by the 1974 General Assembly and approved by the voters in 1975. This amendment affected thirty-three sections of the Constitution, all of which related to the court system.

Section 256 of the Kentucky Constitution, as amended in 1979, presently provides in part that:

> an amendment may relate to a single subject or to related subject matter and may amend or modify as many articles and as many sections of the Constitution as may be necessary and appropriate in order to accomplish the objectives of the amendment.

This language is, of course, broader than the earlier language, under which the decisions discussed above were rendered. Thus, in all probability, the courts today would interpret challenges to the "one subject rule" even more broadly than they were under the earlier language of Section 256. The suggested general revision of the Kentucky Constitution, to include sections which have been overruled or substantially modified by court decisions or federal law, which are obsolete, or which are simply not being enforced, may be included in one amendment, entitled "AN ACT proposing an amendment to revise and correct the Constitution of Kentucky," so long as substantive changes are not included in the amendment. A similar title is used for the biennial statute reviser's bill, which must also adhere to a "one subject rule." Such a bill is submitted during each General Assembly session as a "cleanup bill," to revise and correct the statutes; it contains no substantive changes.

OTHER ISSUES RELATING TO ELECTIONS AND CONSTITUTIONAL AMENDMENTS

Constitutional Limitation of State Taxation and Spending

Issue

Should the General Assembly propose to constitutionally limit state taxation and spending?

Background

During the 1980 Regular Session of the General Assembly, the Senate Elections and Constitutional Amendments Committee considered SB 190, a bill containing as its major point a constitutional limit on state revenue collection and spending tied to total personal income within the State. After public hearings and committee discussion, SB 190 was reported favorably, only to be recommitted to the Senate Appropriations and Revenue Committee.

The 1980-81 Interim Joint Committee on Elections and Constitutional Amendments has already devoted one meeting to discussion of the limitation scheme embodied in SB 190. Indications are that sponsors of the bill in 1980 will again push for the approval of similar legislation in 1982. The interim committee therefore plans at least one public hearing on the topic prior to interim completion.

Major points included in the proposed constitutional amendment introduced in 1980, and probably to be introduced in 1982, include: limitation of state taxation and spending to twelve percent of the total personal income in the state; provisions for property tax rate adjustments according to increased property value due to inflation; provision for refund of taxes in the event that total state revenues exceed thirteen percent of personal income; and continued requirement of a balanced budget.

Supporters of this legislation argue that such a plan would allow state government to grow, but only at a rate equal to the growth of personal income. Government growth in excess of the growth rate of personal income results in additional costs that must be met by already overburdened taxpayers, according to these supporters. Opponents point out the undesirability of including in the constitutional document items that would so strictly control state finance, because of the difficulty of altering or removing such devices, should changes be deemed necessary in the future.

Increase of Homestead Exemption Benefits

Issue

Should the General Assembly propose to amend the Constitution of Kentucky so as to increase the amount of homestead exemption benefits granted under Section 170?

Background

It seems that during every session of the General Assembly, some discussion arises regarding adjustment of the homestead exemption provision found in Section 170 of the Kentucky Constitution. The provision was proposed by the 1970 General Assembly (approved November, 1971), reworded by the 1974 General Assembly (approved November, 1975), and expanded to include disabled beneficiaries by the 1980 General Assembly (to appear on the November, 1981, ballot).

The 1980-81 Interim Joint Committee on Elections and Constitutional Amendments has received for consideration prefiled bill 82 BR 40, which would increase to $20,000 the value amount of property exempted from taxation under the "homestead" provision. A corollary issue concerns the desirability of continued application of the "rubber dollar" theory to the exemption, should an increase be proposed.

In addition, it is expected that the committee will deal with the issue of a non-increasing or "cost" assessment program for property owners over age sixty-five. Such a program would require a constitutional amendment and would be closely related to the homestead exemption.

Bar Association Membership

Issue

Should the General Assembly propose to amend the Constitution of Kentucky so as to require that membership in any bar association by attorneys licensed in this State be voluntary rather than mandatory?

Background

The legal profession in Kentucky is the only major profession that requires its members to maintain membership in a professional association, the Kentucky Bar Association. The General Assembly may not address this issue by statute, in that Section 116 of the Kentucky Constitution allocates to the Supreme Court exclusive power to govern admission to the Bar and qualifications therefor.

This issue was indirectly addressed during the 1980 session of the General Assembly, through HB 228, a proposed constitutional amendment which would have allowed the General Assembly to share rule-making power regarding the courts with the Supreme Court. HB 228 failed passage, of course.

The 1980-81 Interim Joint Committee on Elections and Constitutional Amendments has before it for consideration 82 BR 42, a proposed constitutional amendment which would continue to allow the Supreme Court complete control over Bar membership but would specifically make professional association membership voluntary.

Removal of Salary Limitations for Municipal and County Officials

Issue

Should the constitutional salary limitations for municipal and county officials be removed?

Background

The Kentucky Constitution, at Section 246, establishes maximum salaries of $12,000 for mayors of any city of the first class and $7,200 for all other municipal and county officials. County judges/executive are included under the $7,200 limitation. The impact of these limitations has been modified by the ruling in Matthews v. Allen, 360 S.W. 2d 135 (1961), which related these maximums to the changing value of the dollar. Thus, the salary maximums are periodically adjusted, based on the consumer price index, so that salaries increase as the price index rises.

If these limitations were removed, a new provision could be included in this section to require the General Assembly to establish the salaries.

Abolition of Certain Offices Within Urban-County Governments

Issue

Should the Kentucky Constitution be amended to eliminate the offices of constable, magistrate, commissioner and either mayor or county judge/executive in a county utilizing the urban-county form of government?

Background

In Fayette County, where there is an urban-county form of government, the mayor is the chief executive officer. Thus, the only duties of the county judge/executive are to appoint other county officers in case of death or resignation; to preside over fiscal court, which meets once a year; to sign orders and to administer oaths to new county officers; and to perform weddings. The fiscal court commissioners in an urban-county government, as it was formulated in Fayette County, have but one duty, to meet once or twice a year to approve secondary road funds and school taxes. Constables in all counties are paid on commission for serving legal papers. The magistrates, or justices of the peace, in any county which has chosen to elect commissioners rather than magistrates to serve on the fiscal court, have no governmental duties; they may perform weddings.

Electioneering Near the Polling Place

Issue

Should a county legislative body be permitted to prohibit electioneering at a specified distance from the polls on election day?

Background

KRS 117.235 prohibits electioneering at the polling place on election day unless the county legislative body authorizes electioneering and establishes the distance from the polling place where such electioneering may be permitted, except that no electioneering shall be permitted within a fifty-foot perimeter of the voting machine.

Electioneering includes the displaying of signs and the distribution of campaign literature. Both candidates and voters have express dissatisfaction in areas where a county legislative body has established a distance much greater than fifty feet from the polling place within which electioneering is permitted. Some candidates would prefer to distribute campaign literature in close proximity to the polling place, while some voters have experienced difficulty in locating polling places when there are no signs near the polling places.

Voting by Disabled Persons

Issue

Should the General Assembly delete the present requirement that disabled voters file a physician's verification of disability with the county clerk before being issued a special ballot for voting purposes?

Background

KRS 117.075 presently requires that disabled voters who desire to vote by special ballot apply for such ballots at least seven days prior to an election. The voter must supply a statement describing the nature of the disability, as well as a physician's statement corroborating the disability.

The 1980 General Assembly considered but failed to enact two pieces of legislation (SB 111 and HB 348) that would have repealed KRS 117.075 and treated disabled voters as voters applying for absentee ballots. Such action would effectively delete the requirement for a doctor's verification of disability. The 1980-81 Interim Joint Committee on Elections and Constitutional Amendments has already considered and approved prefiled bill 82 BR 62, which proposes to leave KRS 117.075 in effect but to delete that segment regarding physician verification.

Those in favor of such legislation feel it unfair to require the disabled to produce verification of their disability when a prospective absentee voter need not produce verification of his prospective absence. The expense of obtaining physician verification is also noted. Persons opposed focus on possible fraud in obtaining special ballots, were the verification requirement to be deleted, and object to legislation that makes it easier for the electorate to vote other than at the polls.

Assistance at the Polls for Illiterate Voters

Issue

Should the General Assembly delete provisions that allow illiterate persons to be assisted in voting by a person of their own choice?

Background

KRS 117.255 provides that voters who are disabled or illiterate may, upon the making of an oath to such effect, receive assistance in voting from two election officers or, at the voter's request, from a person of his own choosing. The 1980-81 Interim Joint Committee on Elections and Constitutional Amendments has been presented with information that such a practice, at least with regard to illiterate voters, may encourage illegal vote buying. As an example, a voter might falsely swear to be illiterate so that a person of his choosing, the vote purchaser, could "assist him" or, in reality, see that he voted "properly" before payment. It has been suggested, therefore, that KRS 117.255 be amended so as to require illiterate voters to receive assistance only from election officers.

Energy

POWERS OF MUNICIPAL ELECTRIC COMPANIES

Prepared by Linda Kubala

Issue

Should municipal electric companies be allowed to work together to obtain bulk power supplies? Should the state oversee these companies in any way?

Background

Kentucky's municipally-owned and operated electric companies are not subject to regulation by the Public Service Commission. Some of the activities of these utilities, however, including their ability to control bulk power supplies, are restricted by statute. The municipals would like to remove restrictions against power sales to other cities or to cooperatives, and they advocate legislation to allow several municipal companies to pool resources to purchase or generate power. Opponents argue that municipals should be regulated by the state, particularly if they expand operations beyond the city limits.

Kentucky's 28 municipal electric companies together serve about 13 percent of the state's electric customers. Three of these operate their own generating facilities. The others purchase power at wholesale from the Tennessee Valley Authority (13), Kentucky Utilities company (11), Kentucky Power (2), or Union Light, Heat and Power (1).

Legislation passed in the early 1970s prohibits rural electric cooperatives from servicing municipals (KRS 279.125), and generally prohibits cities from selling surplus power to other cities (KRS 96.520). These restrictions leave most municipals with only one source of wholesale power.

These restrictions have come under increasing attack from cities served by investor-owned utilities. The federal Southeastern Power Administration (SEPA) has made large amounts of low-cost hydroelectric power available to Kentucky municipal electric companies. Kentucky Utilities Company, however, has refused to transmit, or "wheel," this power from the Kentucky-Tennessee SEPA sites to the municipals serviced by the company. This action by Kentucky Utilities Company effectively maintains the "captive customer" status of the municipals it serves, and the situation has led to the filing of a federal antitrust suit against Kentucky Utilities Company on behalf of 11 municipal wholesale customers and Berea College.

Controversy over the restrictions of KRS 96.520 has also attended the development of hydroelectric power by the city of Vanceburg. Vanceburg has obtained permits to develop generating facilities on several Ohio River dams. Facilities on the Greenup Dam (70 megawatt capacity) should be in operation by the end of 1982. Under the present law, Vanceburg cannot sell its surplus electricity to other cities in Kentucky; federal requirements prohibit sale of more than 25 percent of its power to private companies. So Vanceburg has contracted to sell its surplus power to Hamilton, Ohio, and Kentucky users will not benefit from this inexpensive source of power.

Because of these developments, the Municipal Electric Power Association of Kentucky (MEPAK) advocates removal of the restrictions in KRS 96.520 and 298.125. A bill to this effect was introduced but failed in 1980 (HB 899). MEPAK also advocates legislation allowing municipals to form "joint action agencies." Under "joint action," two or more municipal companies could create a joint agency, which then could purchase large blocks of power or construct generating facilities, financed by tax-exempt bonds, and provide services to the member municipals. Some form of joint action legislation has passed in 32 states.

While municipals seek greater flexibility in obtaining bulk power, others have complained that the self-regulation they enjoy no longer is sufficient, and that some of their activities, at least, should be regulated by the state. Municipal utilities were removed from the jurisdiction of the Public Service Commission in 1936. In theory, at least, municipal utilities are controlled by their customers through elected city officials, so there is no need for additional outside regulation. Some of the municipal electric companies, however, also serve customers outside the city limits. Some of these customers feel that since they cannot vote for the officials whose policies directly affect them, they are not being represented in utility matters and these municipals may have no interest in responding to their specific problems. The practice of charging higher rates to outlying customers led to the enactment of KRS 278.047 in 1976, which requires that rates and service standards be the same for customers inside and outside the corporate limits.

A complaint by residents of Greenup County against the Vanceburg utility over the placement of transmission lines has prompted the prefiling of BR 180, which would place activities of municipal electric companies that are outside their corporate boundaries under the Public Service Commission. These citizens argue that under present laws no one in the state may hear their complaints and force the neighboring utility to negotiate with them, since neither the Greenup fiscal court nor the Public Service Commission has any power over the utility. Only the Federal Energy Regulatory Commission could order a change in the placement of these lines.

Discussion

At first glance the two issues, that of expanded power for municipals, and that of state regulation or oversight, appear unrelated, yet they need to be considered together. Generally, the call to regulate municipals extends only to their activities outside city limits. Some municipal utilities are charged with poor management or maintenance, but there is little argument that these utilities do respond to the wishes of their "regulators," the voters within their jurisdictions. Outside the corporate limits, however, local populations have no control over a city's actions. The creation of joint action agencies to pool municipal resources and provide power to their member cities, or the removal of existing statutory restrictions on municipal electric companies, could well lead to an increase in the number of projects undertaken by municipals outside their boundaries, and to the need to protect the interests of affected parties outside the cities. There also is a serious question of whether self-regulation could protect the interests of customers or members in a multi-city joint power agency. The Federal Energy Regulatory Commission does not regulate the wholesale rates charged by municipals or cooperatives. Although each member municipal system might be represented on the board of the joint action agency, municipal customers could be less able to influence the agency's activities.

The rate of increase in electricity consumption has slowed markedly since 1973. Some companies have delayed planned construction projects because the additional capacity is not needed. The Public Service Commission is concerned with avoiding the construction of excessive generating capacity in the Commonwealth, since this would increase customer costs. Instead, the commission is encouraging utility interconnections and maintenance of joint reserves which can be drawn upon by any member of the system. Joint action agencies might build their own facilities, although they are more likely to try to purchase shares in the output of existing plants. If new capacity is planned, the Public Service Commission argues that it should be subject to commission approval.

There appears to be considerable justification for removing those prohibitions on municipal activities which effectively limit them to one wholesale supplier. Similarly, there seems to be no intrinsic reason to oppose enabling legislation allowing municipals to form joint action agencies with defined powers and obligations; the idea is not unlike that put into practice by Kentucky's rural electric cooperatives with the creation of two generating cooperatives, East Kentucky Power and Big Rivers, to supply power to members. The main argument against giving these utilities expanded powers seems to stem from a concern that these powers will not be limited by any effective control.

The trend in Kentucky, as in the nation, is to less, not more, regulation. Fifty years of experience with increasingly pervasive regulation of more and more sectors of the economy have shown that regulation sometimes causes problems, rather than solves them. Kentucky's municipal utilities often charge rates lower than those of neighboring privately-owned utilities. In part, this difference may be because municipals do not have to conform to numerous, cumbersome regulations of state and federal agencies, or submit every proposed action, with voluminous documentation, to an oversight agency for review. Municipals argue that their rates would go up if they came under Public Service Commission control, an argument which seems to be borne out by the experience of private sewer companies, since their regulation in 1974.

Some form of oversight, or some non-judicial appeals process may be necessary, if municipal electric companies are given increased powers beyond their borders. Regulation, however, is not a panacea to be used indiscriminately, and control should be tailored to the actual need to prevent potential abuses.

INCENTIVES FOR SOLAR AND RENEWABLE ENERGY DEVELOPMENT

Prepared by Linda Kubala

Issue

Should the state give tax incentives to those who invest in solar or renewable energy?

Background

Kentucky is one of the few states without legislation to encourage the development of solar energy. The only tax incentives for renewable energy in the state are those for gasohol production (HB 838, 1980). Solar incentive legislation was introduced in each of the past three sessions, but failed. Continued interest in this area, however, led to the passage in 1980 of HCR 42, which created a Special Solar Energy Advisory Committee to study the potential of solar and renewable energy development in the Commonwealth, and to make recommendations to the 1982 General Assembly. The committee has determined that a number of solar/renewable applications can be practical in this part of the country, and finds that rapid development of these alternate energies will have a positive impact on the state's economy. The committee is therefore working on several pieces of legislation to facilitate the development of solar/renewable energies in Kentucky, including a 30 percent income tax credit for investments in solar or wind energy. A proposal for a grant and loan program also is being developed.

Discussion

An investment in solar or renewable energy generally represents a decision to pay more initially in capital costs in order to minimize operating costs over the life of a system. A number of solar applications, such as solar hot water heating, are available on the market today, are widely used elsewhere in the country, will operate effectively in Kentucky, and can be expected to pay back their higher purchase cost within a few years because the owner does not have to purchase energy to operate them. A homeowner purchasing a hot water heater, however, is likely to weigh the initial cost for equipment more heavily than the fuel costs he will pay in future years. Thus, the high initial cost of solar acts as a barrier to widespread adoption, even though its use may be cost-effective, and in the individual, state and national interest.

A tax credit for investments in solar and renewable energy would lower this initial cost. Such credits are designed as a temporary measure, to encourage more people to try solar technologies than otherwise might do so, in order to hasten their commercialization and widespread use. The underlying assumption is that such systems as active and passive space heating and hydrothermal or wind systems are viable and can compete on their own merit without subsidy, once they reach a certain point of development.

Proponents of a solar/renewable energy tax credit argue that a Kentucky tax incentive is needed to hasten the process of development and consumer awareness in the state. On the other hand, income tax credits already are available at the federal level. Individuals may apply for credits of up to 40 percent on the cost of qualifying solar, wind and geothermal systems, and businesses may claim additional investment tax credit for such systems. These credits generally do not apply to passive solar designs, which would be included in Kentucky legislation. However, opponents of a tax credit argue that existing federal incentives should be a sufficient encouragement to homeowners and businesses to install solar, and state action is not needed.

There is some indication that Kentucky is being bypassed by solar developers and manufacturers because it does not provide tax incentives. Forty-two states offer tax incentives in addition to the federal credits. Twenty-eight of these give income tax credits. Proponents of a tax measure fear that, without some sign of official encouragement, Kentucky will be unable to compete with other states in attracting parts of the growing solar industry.

Kentuckians have shown considerable interest in solar and renewable energies. Tax incentives typically are designed to encourage taxpayers to take actions considered desirable, but which they are not inclined to take by themselves. Tax incentives were not needed to encourage the widespread use of woodburning stoves, and there is some indication that other renewable technologies also are catching on without state government help. The Department of Energy has identified about 300 solar installations in the state, and many more probably exist. Most of these were built or installed within the past two or three years. The number of solar projects is minor compared to the number of buildings in Kentucky, but rapid increases in the number of installations being planned and carried out during a recessionary period in the building industry in general may indicate that development in this area already is rapid. If this is true, then additional tax incentives may not be needed.

Any tax credit will cost the state something in the form of lost revenues. The experience of other states shows that revenue losses from solar tax credits are relatively minor, since less than one percent of all taxpayers typically apply for the credit. Tentative fiscal estimates prepared for the Solar Energy Advisory Committee place anticipated revenue loss at about $400,000 per year, based on the experience of other states with similar legislation. If it can be assumed that the credit causes an increase in the number of systems installed in Kentucky, then part of this revenue loss will be offset by additional sales tax revenues, and from taxes on the additional employment and business income. Still, increased revenues are not likely to offset revenue loss from a substantial income tax credit. The General Assembly must weigh this cost against the possible economic impact of a growing solar/renewable energy industry.

OTHER ISSUES RELATING TO ENERGY

Community Impact Assistance For Synfuel Developments

Issue

Should the state provide assistance to communities to help them deal with short-term impacts of large synfuel developments?

Background

Plans are underway for the construction of four huge synthetic fuel plants in three adjacent west Kentucky counties. These plants will represent an unprecedented industrial investment in the area and will upon completion become a major factor in the economic life there. During the construction phase, however, these plants will cause severe disruption to the communities and the great number of construction-related employees entering the community will place great demands on local public sector facilities. Schools, highways, water and sewer systems will all experience a tremendous surge in the demands placed on them. This surge will in turn necessitate a considerable increase in local government spending on these public facilities.

The problem for local governments is that though many of these increased costs will be incurred almost as soon as construction begins, the bulk of the revenues the plants will ultimately generate will not be realized until the plants become operational several years later. Local tax structures have traditionally not been designed to accommodate dramatic surges in local employment and economic activity. Additionally, some of the communities impacted by the plants will receive no direct revenues from the plants themselves or their employees.

Among the suggestions for helping local governments cope with these problems are:

1. Create a state-financed impact fund to allow local governments to borrow against future revenues to meet needs during the early phases of the plants' development.

2. Make direct loans to affected communities.

3. Allow special taxes or fees to help insure that communities bearing the burdens of the plants will also share equitably in the benefits.

Oil Shale Development

Issue

Should the state encourage oil shale development, and should the state allow developments to be financed through the Energy Development and Demonstration Trust Fund?

Background

Kentucky has tremendous amounts of oil trapped in Devonian shale deposits. These deposits lie at or near the surface in an arc around the outer Bluegrass region. Oil from these deposits is currently being processed only in one small experimental operation, but several mineral companies are actively buying leases to mineral rights in the shale areas.

There is considerable interest in the development of these deposits, and also determined opposition by local residents, who fear the environmental effects of large-scale mining. The 1980 General Assembly placed a moratorium on shale mining, pending the development of environmental regulations by the Department for Natural Resources and Environmental Protection. The administration, through the Department of Energy, has expressed keen interest in encouraging large-scale shale oil developments. Retorting and refining facilities for shale oil involve huge investments and sophisticated techniques, comparable to those for coal gasification and liquifaction technologies. It has been suggested that the Energy Development and Demonstration Trust Fund be used to help finance such facilities. At present, the $55 million fund may be used only to encourage techniques or processes to convert coal into clean fuels in liquid, gaseous, or solid forms (KRS 152.750).

Health and Welfare

MEDICAID COST CONTAINMENT

Prepared by Mary Yaeger

Issue

What types of cost containment proposals for the Kentucky Medical Assistance Program are likely to be faced by the 1982 General Assembly?

Background

In 1965, Congress passed an amendment to the federal Social Security Act which assured medical care for the poor, as well as the aged. This amendment is known as Title XIX, or "grants to states for Medical Assistance." In the Commonwealth, Medicaid is an assistance program for all or part of the medical services to eligible low-income residents of the state.

The Medicaid program is financed through federal and state taxes, with the federal government spending two dollars for every one spent by the state. Within federal guidelines, the state determines the eligibility criteria, benefit levels, and rates of payments to health care providers. At its source, Medicaid is a federal program, but in Kentucky the responsibility to operate the program rests with the Department for Human Resources, Bureau for Social Insurance.

There are two categories of Medicaid recipients:

(1) The Categorically Needy: Those families who receive Aid to Families with Dependent Children (AFDC), the aged, blind and disabled individuals who receive Supplemental Security Income (SSI) benefits or State Supplementation.

(2) The Medically Needy: Those families or individuals who <u>do not</u> qualify for AFDC or SSI or State Supplementation because their income is too high for these benefits, but who do not have enough income to cover their entire medical needs.

The federal law requires the states to offer the medically indigent nine types of services and allows the states to offer one or more other optional services. The mandated services and those optional ones that Kentucky chose to provide are listed below:

Mandated Services

Hospital Care: Inpatient
Hospital Care: Outpatient
Physician Care
Rural Health Clinic Services
Other Laboratory and X-ray Services
Skilled Nursing Services

Early & Periodic Screening, Diagnosis and Treatment (EPSDT)
Home Health Care for Over-21 Population
Vision and Hearing Services for Under-21 Population

Optional Services

Pharmacy Services
Dental Services for Over-21 Population
Primary Care Services
Intermediate Care Services
Transportation for Medical Services
Community Mental Health Services

Nationally, Title XIX spending increased from $1.9 billion in 1967, the first full year of operation, to $25.3 billion in combined state and federal dollars in FY 1980. The "unconstrained growth" of Medicaid has caused the federal government and at least two-thirds of the forty-nine participating states, including Kentucky, to suffer significant financial difficulties. In FY 1980, total federal and state expenditures in Kentucky's Medicaid program were $302,610,809. By contrast, 1967 expenditures were $23,629,538. Medicaid's portion of the general fund has been increasing each year. In 1980, it constituted 5.4% of the general fund, and, if unchecked, it will consume over 8% of the general fund by FY 1985.

While expenditures have skyrocketed, the average number of Medicaid recipients is approximately the same today as it was in 1975. Some major factors explaining the increased expenditures are:

(1) An increase in the utilization rate by recipients from 43% in 1970 to nearly 49% in 1981.

(2) High inflation in general and a higher inflation rate in the medical care industry.

(3) The growing number of eligible recipients 65 years of age and older who are utilizing the more expensive institutional services (hospitals, skilled nursing facilities, and intermediate care facilities).

(4) A series of expensive incentives built into the health care system (i.e. a reimbursement structure that encourages providers to increase the quantity of services delivered; and reimbursement for inpatient hospitalization based on "reasonable costs," similar to the Medicare reimbursement principles).

The 1980 Kentucky General Assembly was aware of the impending biennial cost overrun and, through House Bill 931, directed the Department for Human Resources "to develop and implement by the second year of the biennium (FY '82) a Medicaid Cost Containment Plan." Following this directive, the Secretary for Human Resources, in January, 1981, presented a thirty-four item plan of action for containing Medicaid costs. Following revision of applicable Kentucky Administrative Regulations, most of the Department's cost containment features were put into effect April 1, 1981.

Many items in the plan were directed toward the very expensive and inflationary institutional services. Medicaid payment for hospital bed days was reduced from 21 to 14 days, weekend admissions were eliminated, as was the routine reimbursement for a standard battery of lab tests. In nursing homes, grace days for making alternate arrangements for patients when they no longer need a particular level of care were reduced from 30 to 10. Only actual days of care were authorized for reimbursement, eliminating reserve bed days, with a patient's income applied in the month following admission into a nursing home rather than waiting two months. The Department hopes to save around $40 million by the end of Fiscal Year 1983 through a three-year phase-in of cost containment measures. In FY 1981, the projected combined state and federal deficit, with cost containment, is $35.9 million. The FY 1981 cost containment plan is projected to save $9.3 million, leaving the FY 1981 Medicaid program with approximately a $10.8 million general fund deficit, which was absorbed by other departmental program funds.

In addition to the cost overrun in Kentucky, the state is facing Congressional budget cuts, which will cause an even larger financial deficit for the state. As of this writing (July, 1981) Title XIX is undergoing revisions by the introduction of three Congressional bills: (1) the Administration's bill; (2) the House Committee on Interstate Commerce bill; and (3) the Senate Finance bill. The Administration's bill would place a 5% cap on Medicaid for FY 1982, and use the GNP deflation cap for future budgets. For Kentucky this 5% cap means a loss of approximately $16 million in federal revenue. The House Committee bill would set no cap, but would cut the federal match 3% in FY 1982, 2% in FY 1983, and 1% in FY 1984, unless the states have effected cost controls or have high unemployment. The Senate bill would place a 9% cap on Medicaid for FY 1982 and apply the GNP deflation cap for future years, while lowering the federal match from 50% to 40% in twelve states that have a high per capita income (this would not apply to Kentucky).

Discussion

In light of pending federal cuts, the Kentucky General Assembly will be reviewing state Medicaid proposals that attempt to contain expenditures in new ways the federal government has not previously permitted. For example, states have been prohibited from treating one diagnostic group differently from another (i.e. neo-natal babies could not be covered for a longer period in the hospital than elderly patients). The recipients have been free to go to any provider who would accept the Medicaid card and there was no incentive to limit the number of services given. Also, reimbursement mechanisms did not encourage the more competitive, least expensive product or service.

The Reagan Administration's "flexibility provisions" would allow states to have more control over their Medicaid programs in terms of how the limited federal funds will be spent. The specific details of the flexibility provisions have not yet been determined, nor is it clear whether they will be proposed as amendments to the federal law or if the Secretary for Health and Human Services will have more authority to waive federal regulatory compliance on an individual state basis. There are five flexibility provisions which would allow states new freedom to administer their programs in cost-effective ways. These are:

1. Eliminate the patient's freedom to choose whichever health care provider (i.e., doctor, hospital, etc.) they want, given the provider accepts the medical card. This change would allow the state to act as "prudent purchaser," buying services which would be most cost-effective. It may also allow competitive bidding by states for services.

2. Eliminate basing reimbursement requirements on "reasonable cost" and substitute more cost-conscious means for determining a set rate for payment of services.

3. Waive the 50% restriction of Medicaid/Medicare enrollment in Health Maintenance Organizations (HMOs), which presently does not permit more than half the health plan members to be Medicaid/Medicare recipients.

4. Allow the state the option of providing less than the full range of services to the medically needy population. Also permit some diagnostic groups more services than other groups.

5. Allow copayment by recipients for services received on the basis of diagnostic groups (i.e., some patients would have to help pay for certain types of services).

The Medicaid budget, prepared by the Executive Branch for legislative review and approval, will contain a funding request that takes into consideration the limited available state and federal dollars and maximizes the new flexibility provisions, as an attempt to control costs. The legislature will have to respond to departmental proposals in four general areas: (1) the range and number of services offered to the recipients; (2) the criteria which makes a person eligible for services; (3) the amount and method of provider health reimbursement; and (4) the Department for Human Resources' efforts to improve administration and management of the program.

The purpose of this paper is to cite some areas in which change may be expected and consideration may be warranted, without the benefit of knowing the specific Congressional budget or Department for Human Resources budget proposals.

In the area of changing the range and number of available services, service curtailment is of two basic types: (a) <u>discontinuing or restricting service access</u> (e.g. limiting the number of hospital days covered by the program or requiring the recipient to pay part of the service cost); and (b) <u>restricting the availability of care</u> (i.e., limiting available hospital beds, non-emergency use of emergency rooms, the number of physician visits covered by the medical card, and locking a patient into one service curtailment). It will be important to determine whether the services will be offered in amounts sufficient to reasonably achieve the purpose for which they were provided. Will the limitation of prescription coverage allow the patient's condition to improve adequately? Will the length of hospital stay allow the patient to recover adequately? Or will the treatment terminate before at least a minimum degree of health is achieved?

The criteria for eligibility determination is another area in which the state will be making cost-cutting changes. The state will decide whether to provide services to the medically needy and, if so, how much service to provide. The proposal may set new limitations on the financial resources a recipient may have and remain eligible. The Department may require a greater medical need for qualification for services. (This is already the case with intermediate care facility eligibility.) Certain groups may be eligible while other groups may not be eligible. The new flexibility provision probably allows a great deal of administrative discretion regarding who may receive services and who may not. A close review for favoritism, discrimination and equality in treatment may be desired in reviewing who receives services and who does not. Also, the effort to save Medicaid dollars must maintain a balance between spending federal-state Medicaid dollars and potentially having indigent groups not covered by Medicaid using alternative total state or locally-funded services, thus actually costing the state more money.

In the area of provider reimbursement a gamut of strategies has already been proposed as a means of restricting provider charges. Since the largest portion of Medicaid funds is spent on the expensive inpatient care (hospitals and nursing homes), limits are already being applied to chargeable fees in this area. The state will have more authority, however, to set rates of other services by cost containment formulas than with the present "payment may not exceed reasonable charges" clause. However, reductions in provider fees may have some negative side effects. For example, more physicians may choose not to accept the Medicaid patient, thus forcing the patient to seek health services in the more costly hospital out-patient departments, or to receive no care at all until his condition requires hospitalization.

Finally, in the area of improved state level administration and management, the General Assembly may see a budget request for funding: a comprehensive automated data system called the Medicaid Management Information System (MMIS), expanding of the third-party liability recovery program, and establishment of a series of restrictions and conditions in processing eligibility applications and reimbursement claims. The legislature may want to review these policies to assure that they are truly cost-savings practices.

In summary, the General Assembly will be asked to approve a costly Medicaid program that, for a number of reasons, primarily financial, is in need of revision. Because of new flexibility provisions in the federal/state program, some innovative and dramatic differences may be seen in Medicaid. Specifically, changes in services, eligibility, reimbursement and management may dramatically affect medical care of the indigent. Legislators will want to judge the merits of the changes based on their short- and long-range cost benefits, as well as the degree to which the new proposals will meet the health care needs of the Kentucky indigent populations.

The cost-containment proposals which will face the General Assembly will reflect a FY 1982 deficit of $35 million, despite the Department's present cost-containment activities. In FY 1982 expenditures of between $425 and $430 million will leave the program between $9.6 and $11.2 million short in general fund dollars, without considering the federal budget cuts. The General Assembly may be asked to supplement the FY 1982 budget, as well as pass a new biennium budget which the Department can live with and which takes into account the new limitations on spending placed by the federal government.

NURSING HOME REFORM

Prepared by Bob Gray

Issue:

Are additional sanctions needed to enforce state standards regulating Kentucky's nursing homes?

Background

The Commonwealth of Kentucky spent $128,825,066 in Medicaid payments for FY 1980 for nursing home care for Kentucky's indigent citizens. Approximately 80% of all nursing home beds in Kentucky are paid for by Medicaid. Given the Commonwealth's substantial investment in nursing home care, a great deal of attention has been focused on the quality of services being purchased with public dollars. Facilities which are currently receiving Medicaid funds but which are not in compliance with regulations setting standards for the health and safety of the residents are a continuing concern. At issue is the effectiveness of the Department for Human Resources' enforcement methods in combatting non-compliance with regulations and the ensuring of a safe and healthful environment for the residents of long-term care facilities.

All long-term care facilities in Kentucky are required by KRS Chapter 216B to obtain a Certificate of Need and a license prior to operating. The Kentucky Health Facilities and Health Services Certificate of Need and Licensure Board issues regulations setting standards for the construction, alteration and operation of long-term care facilities. To receive a license to operate the facility must comply with these standards. If the facility wishes to participate in the Medicaid program so it may receive reimbursement from the Department for Medicaid eligibles residing in the facility, it must comply with federal standards and be certified by the Department to participate in Medicaid. Facilities are inspected annually to determine their compliance with state licensing requirements and, if applicable, compliance with federal Medicaid regulations. If an inspection reveals a deficiency in a given area, such as recordkeeping, handling of medication, cleanliness of the facility, or food preparation, the facility is issued a "statement of deficiency" by the Department. The facility, in turn, provides the Department with a "plan of correction," stating what actions will be taken to remedy the deficiency. The Department then conducts a follow-up inspection to determine if the appropriate action has been taken to correct the deficiency. If the deficiency is corrected, no problem exists. However, what the Department should do when a facility fails to correct a deficiency is a matter of controversy.

The Department has two alternatives in dealing with such facilities, unless the deficiency is simply overlooked. First, the facility's license may be revoked by the Kentucky Health Facilities and Health Services Certificate of Need and Licensure Board. Second, if applicable, the facility may also be decertified from participation in the Medicaid program.

Critics argue that these methods are too severe and have no relationship to the type of deficiency or violation. Revoking the license of a facility is a lengthy process and, if successful, would force the facility to close. All of the residents would then have to be relocated in other facilities - if space were available. Experience has shown that many fragile elderly residents moved from familiar surroundings suffer from "transfer trauma" and are subject to more immediate harm than would be caused by remaining in a facility with substandard conditions. Decertification from the Medicaid program would produce a similar result, as Medicaid patients would be forced to move into a Medicaid-certified facility with an available bed. Locating an available bed may be difficult, due to the current moritorium on expansion of long-term care beds in Kentucky. The extreme nature of delicensure or decertification from Medicaid and their undesirable consequences make these sanctions difficult if not impossible to use. As less extreme enforcement measures are not available, some facilities are operating with deficiencies from year to year.

Discussion

A number of states have employed less severe sanctions than license revocation or decertification to force facilities to correct deficiencies that are not actually life threatening but relate to sanitation and individual care. One such method is a "citation system," whereby facilities are cited for violations that are classified according to severity. The facility is given a specified time period to correct the violation and a fine is then assessed if the facility fails to do so. Violations are classified as Class A, life threatening, and Class B, non-life threatening but directly related to the health, safety and security of the residents.

Another approach adopted by several states is legislation authorizing the appointment of receivers in substandard nursing homes. Such legislation permits courts to appoint a receiver upon the application of a state agency, a resident of a nursing home, or other interested parties. The conditions under which the court may appoint a receiver vary among states, and may include operating without a license or after being delicensed or decertified, life threatening conditions or preparing to close without making provisions for the transfer of residents. The authority to appoint the receiver lies exclusively with the court. A receiver is empowered to operate the facility in all respects for a specified time or until all deficiencies have been corrected. Receivership is usually limited to cases where severe violations jeopardize the health and safety of all residents of a facility and new management is seen as the best way to correct conditions.

The states of California, Minnesota, West Virginia, New Jersey and New York have enacted specific legislation authorizing their state health agencies to enforce nursing home licensure laws and regulations through injunctions. A facility may be held in contempt of court for failing to comply with a court ordered injunction that directs the facility to refrain from certain activities. Advocates of this approach argue that hearings and relief of conditions can be obtained quickly and that injunctions can directly mandate correction of violations. However, some commentators have pointed out that this method is limited, in that courts may be unwilling to issue an injunction in a case involving nursing homes and some nursing homes may not be willing to comply with the injunction.

The enforcement mechanisms discussed above are only a sample of options available to the Commonwealth to assist in strengthening the equality of long-term care. Rating systems, legislation mandating access to facilities for interested persons, transfer requirements, nurse's aide training, and minimum staffing patterns are additional ways states have attempted to ensure facilities' continued compliance with health and safety standards. However, many of the alternative methods discussed here are as controversial as delicensure and decertification. Critics of citation systems maintain that it is impossible for facilities to remain totally in compliance with all applicable laws and regulations. Fining a facility for non-compliance, they argue, would only detract from funds slated for patient care and hurt all the residents of the facility. Additionally, the nursing home industry in Kentucky maintains that its current rate of reimbursement does not cover operating costs. In this respect, fines and other methods designed to force compliance with regulations could be seen as causing facilities to spend more money at a time when some are operating at a low profit or even a deficit.

Faced with rising Medicaid expenditures on nursing homes, an expanding elderly population, and the general attention placed on the quality of life in Kentucky's nursing homes, the 1982 General Assembly may wish to consider legislation providing for less extreme enforcement mechanisms to ensure a high quality of care in long-term care facilities in the Commonwealth.

GENERIC DRUGS

Prepared by Dianna McClure

Issue

Would Kentuckians realize a greater savings in prescription drug costs if the 1982 General Assembly amended the current generic drug laws to permit (instead of require) generic drug product selection by pharmacists and to establish a negative instead of positive drug product formulary?

Background

Prescription drug products can vary considerably in price. The following table, reprinted from a 1978 Kentucky Law Journal, shows wholesale price differences listed in the Drug Topics Red Book of the same year.

Wholesale Price Differential Between Brand Name and Generic Drug Products

Ampicillin (250 mg. capsule form)

Brand	Distributor	Price per 100
Alpen	Lederle	$ 8.61
Amcill	Parke-Davis	11.27
Amperil	Geneva Drugs, Ltd.	4.99*
Omnipen	Wyeth Labs	11.25
Pen A	Pfizer	9.72
Penbritin	Ayerst	14.54
Pensyn	Upjohn	13.69
Polycillin	Bristol	18.93
Principen	Squibb	15.05
SK-Ampicillin	Smith, Kline & French	7.25
Supen	Reid-Provident Labs	11.95
Totacillin	Beecham Labs	13.75
Vampen	Vanguard Labs	8.00
Generic		
Ampicillin	Bocan Drug Co.	6.75
Ampicillin Trihydrate	Bell Pharmacal	6.46
	Paramount Surgical Supply	5.25
	Pure-Pac Pharmaceutical	6.81
	Zenith Labs	6.00

*Only Available in 500's

For older persons on fixed incomes, persons with chronic conditions requiring prescription drugs, or medically indigent individuals, t[illegible] wide variance between prices for generic and brand name drug products can seriously affect the proportion of their income allocated for health care.

In Kentucky, the General Assembly first responded to the need for reductions in prescription drug prices in 1972, by enacting what is known as "generic drug laws." Current generic drug statutes require pharmacists to select and dispense therapeutically equivalent drug products in stock for a brand name drug product prescribed, if the drug product prescribed is included in a "positive" formulary (list of therapeutically equivalent drug products that may be interchanged) published by the Kentucky Drug Formulary Council. Therapeutically equivalent generic drug products are generally lower priced than brand name products. Unfortunately, the maximum number of therapeutically equivalent drug product entities ever issued by the Kentucky Drug Formulary Council has been less than seventy. Since the United States Food and Drug Administration (FDA) has evaluated about 2,400 multiple-source drug products as being therapeutically equivalent, Kentucky consumers have had limited opportunity to achieve savings in prescription drug costs. In addition, as a cost containment measure, Governor John Y. Brown, Jr., has abolished, by executive order, the Kentucky Drug Formulary Council, effective November 1, 1980. Since the statutes do not authorize the addition of generic drug products to the positive formulary by any other means than the Kentucky Drug Formulary Council, the 1982 General Assembly will have to act, if drug product selection is to be sanctioned and encouraged in the Commonwealth.

Major amendments to the statutes which will probably be under consideration during the 1982 General Assembly will include those which would:

(1) permit rather than require drug product selection by pharmacists;

(2) delete provisions for the positive formulary issued by the Kentucky Drug Formulary Council and provide instead for publication by the Board of Pharmacy (or some other entity) of a list (called a negative formulary) of drug products that could not be interchanged because they have been determined not equivalent by the FDA;

(3) revise prescription format from <u>allowing</u> practitioner prescribers to indicate, by handwritten instructions, that drug products should not be interchanged to <u>requiring</u> prescribers to exercise a choice with each prescription between permitting or prohibiting drug product selection;

(4) prohibit substitution of therapeutically equivalent drug products unless the substituted drug product is lower in cost to the purchaser than the drug product prescribed;

(5) require that a savings of 60% of the difference in wholesale cost between the drug product prescribed and that dispensed be passed along to the consumer, thus allowing the pharmacist to retain a 40% cost savings, which should serve as an incentive to substitute;

(6) increase the amount of purchaser-pharmacist interaction by expanding provisions allowing purchaser to refuse drug product selection to include requiring pharmacists to inform purchasers of price differences between brand name product pre-

scribed and therapeutically equivalent products which could be substituted; and

(7) require pharmacists to keep certain information on the prescription pharmacy file copy which would serve as a data base for a study for the General Assembly of the effectiveness of Kentucky's generic drug law.

While there are a considerable number of amendments which will probably be presented to the 1982 General Assembly, for the purposes of this paper only three proposed changes in Kentucky's generic drug laws will be discussed: positive versus negative formularies; permissive versus mandatory drug product selection; and prescription format for prohibiting or allowing drug product selection.

Discussion

The drug product selection (DPS) process is notable for its series of choices made by three key participants. The practitioner prescriber chooses whether to allow or prohibit DPS. The consumer chooses whether to accept, reject, or ask for drug product selection. The pharmacist chooses the brand name and therapeutically equivalent drug products to stock in his pharmacy, the prices he will charge, and the particular drug product he will dispense as a substitute for the brand name product prescribed. The specific choice made by one or more of the participants in the drug product selection process affects the frequency and amount of drug price savings achieved by consumers.

Prescription drug price savings for consumers may be actual or potential. The potential for savings generally depends on:

1. The price variation among therapeutically equivalent drug products each pharmacist chooses to stock.

2. Whether prescribers, by habit, routinely prohibit or allow DPS.

3. Whether state law requires the dispensing of the lowest priced therapeutically equivalent drug product consistent with the pharmacist's professional judgment when a practitioner prescribes generically.

Actual consumer savings in prescription drug prices are said to depend on:

1. Whether state law requires passing on savings to consumers when prescriptions are written generically.

2. Whether state law requires passing on savings to consumers when prescriptions are written for brand name drugs for which multiple-source therapeutically equivalent drug products are available. (Current Kentucky law has a savings pass-on loophole. While the pharmacist is required to substitute the lowest priced therapeutically equivalent drug product in stock, a pharmacist could conceivably stock only high priced therapeutically equivalent drug products. Thus the drug ultimately dispensed could legally be higher in price than the brand name prescribed.)

Data from other states with DPS laws which indicates average savings achieved per prescription by purchasers of prescription drug products is set forth below.

State	Average Price Reduction Per Prescription When DPS Occurred
Michigan	$1.14
Wisconsin	0.87
Vermont	1.14
Rhode Island	0.96
Delaware	0.14

Average price reductions take on added significance for purchasers when the rate of substitution is increased. That is, the more often a consumer is able to purchase a prescription at a reduced price, the greater will be his or her overall savings.

The rate of drug product selection occurring plus the actual consumer savings in drug costs are directly affected by the three probable statutory proposals identified earlier - positive versus negative formularies; permissive versus mandatory DPS; and prescription format for prohibiting or allowing DPS. The pros and cons of each proposal will be briefly presented, as will any data available to date from systematic research studies conducted in these topical areas. Most data presented will be that of the Wayne State University study group (funded by the National Center for Health Services Research), which has studied actual dispensing and prescribing practices in Vermont, Rhode Island, Wisconsin and Michigan. While the FTC has issued a Model Drug Product Selection Act and a staff report, the findings in the report are not based on systematic research, but on review of the literature and on telephone opinionaires.

The first proposal, that of providing for a "negative" instead of a "positive formulary," would entail deleting the provisions requiring that the Kentucky Drug Formulary Council develop, publish and update a list of drug products within drug entities that have been determined to be therapeutically equivalent and therefore interchangeable. In its place there would be a "negative formulary," a list of drug products determined not therapeutically equivalent by the FDA, and thus not interchangeable.

The FTC, in its Model Drug Product Selection Act, and researchers for the Wayne State study group have recommended a positive formulary. The FTC has recommended use of a positive formulary based on the FDA list of therapeutic equivalents. The Kentucky Pharmacists Association has recommended a negative formulary and has urged adoption of the FDA formulary of inequivalent drug products as the state's exclusive formulary. Others have opposed the positive formulary because of the time and administrative expense involved in publishing, updating and maintaining it, particularly a problem when there is state-by-state formulary development instead of adoption of a national positive formulary or placing the responsibility with a federal agency, such as the FDA. Further, some have criticized positive formularies as infringements or limitations on professional judgment.

Arguments for a negative formulary are that it allows pharmacists to apply their professional judgment to its list, assuming it is developed by some nationally recognized body of experts, such as the FDA. Arguments against a negative formulary include the point that it does not protect the public against the previously undiscovered inequivalency of two products that are generically the same. Presumably a positive formulary would discover any inequivalencies before a drug could be placed on the list.

The second proposal, that of allowing, instead of requiring, less costly drug product selection by pharmacists, has been recommended by the FTC in its Model Drug Product Selection Law. The FTC thinks mandatory DPS laws may be unworkable because of pharmacists' resistance to such government intrusion. The FTC thinks providing pharmacists an economic incentive to select low-cost products makes a mandatory law unnecessary. The Kentucky Pharmacists Association and Board of Pharmacy have recommended a permissive DPS law for Kentucky.

Arguments Against a permissive DPS law include the contention that mandatory DPS laws, compared to those which are permissive but otherwise similar, produce higher substitution rates. It is pointed out that pharmacists also exercise professional judgment by choosing the drug products to stock in their pharmacies. By experience and education pharmacists have the ability to eliminate any questionable products.

Research findings on the rate of DPS practiced by pharmacists in states with either permissive or mandatory DPS laws are presented below.

State	Type of Formulary	Permissive or Mandatory DPS	Rate at Which Pharmacists Practiced DPS When Authorized
Michigan	None	Permissive	3.2%
Wisconsin	Positive	Permissive	18.1%*
Vermont	Positive	Mandatory	14.4%*
Rhode Island	Positive	Mandatory	6.6%*
Delaware	Negative	Permissive	56.2%

*Substitution rate is for drug products in formulary.

The third proposal, revision of the practitioner prescription format for prohibiting or allowing drug product selection, calls for determining whether practitioners should decide whether DPS should be prohibited or allowed, with each prescription written (if drug products are multiple source). Also at issue has been the question of how the practitioner's intent should be indicated. The method could include (1) having the prescriber prohibit DPS in his own handwriting; (2) having the prescriber sign one of two preprinted choice lines prohibiting or allowing DPS; or (3) having the prescriber initial or check one of two choice boxes prohibiting or allowing DPS.

One argument for mandating the practitioner prescriber's exercising a choice with each prescription is that practitioners reportedly resent delegating the DPS decision to another profession. Another factor is that unless the law requires notifying the prescriber as to the exact drug dispensed, the practitioner prescriber may not have all the facts he or she needs if the patient does not respond to the dispensed medication.

One argument against mandating that the prescriber exercise a choice with each prescription is that prescribers may by habit always check the prohibiting choice box or sign the prohibiting choice line, and thus the rate of DPS would be minimal. The following table shows the percentage of prescriptions which have DPS prohibited by the prescriber, according to the format on prescriptions allowing or prohibiting DPS.

State	Prescriber Description Format Prohibiting or Authorizing DPS	*% of Prescriptions With DPS Prohibited By Prescriber
Michigan	Handwritten DAW instructions mandated; or may write DAW in space or box adjacent to pre-printed statement.	4.0%
Wisconsin	Handwritten DAW instructions mandated.	1.2%
Vermont	Handwritten DAW instructions mandated.	1.4%
Rhode Island	Prescriber signature on one of two lines mandated.	40.5%
Delaware	Prescriber signature on one of two lines mandated.	62.1%
New York	Prescriber signature on one of two lines mandated.	70.4%

*Figures for all prescriptions.

The various proposals to amend the Commonwealth's generic drug laws will present a complex and controversial situation to the 1982 General Assembly.

OTHER ISSUES RELATING TO HEALTH AND WELFARE

Mentally Ill Criminal Defendants

Issue

Should Kentucky establish a verdict of "guilty but mentally ill"?

Background

The "guilty but mentally ill" verdict, recently adopted in Michigan and Indiana, provides a new option for criminal judges and juries. Presently in Kentucky a defendant is found "guilty," "not guilty," or "not guilty by reason of insanity." The new verdict does not eliminate or change these three verdicts. What the fourth verdict does is impose criminal responsibility on persons who have committed crimes while mentally ill. It recognizes that an individual who commits a criminal act may be less than sane at the time of the act but that his mental state does not qualify as legal insanity.

Generally speaking, under present law, a guilty sane murderer goes to prison while a guilty insane murderer goes free. Recognizing both societal interests and individual needs, the new verdict calls for the imposition of criminal sanctions (prison, probation, conditional discharge) on those found "guilty but mentally ill," but also mandates mental health treatment can be provided them while they serve their sentences. The Supreme Court of Kentucky has commended the "guilty but mentally ill" concept to the General Assembly.

Decriminalization of Public Intoxication

Issue

Should the General Assembly appropriate monies for implementation of Senate Bill 214, which decriminalizes the offense of public intoxication effective July 1, 1982, or should it repeal the law?

Background

The 1980 General Assembly enacted Senate Bill 214, which decriminalizes the offense of public intoxication effective July 1, 1982, but it appropriated no funds for its implementation. The law provides that specially trained treatment teams or police officers shall escort persons appearing to be incapacitated by alcohol in public (unconscious or dangerous) to treatment facilities. Similarly, persons appearing to be intoxicated (functioning impaired) in public may be assisted home or to a treatment facility. Jails will be used only when treatment facilities are unavailable and only so long as the incapacity or intoxication lasts. Training police officers and emergency treatment teams, establishing new treatment facilities, and dealing with reduced revenues for jails are key fiscal issues which will affect legislative action on Senate Bill 214.

Boarding Home Regulation

Issue

Should boarding homes in Kentucky be regulated by the Commonwealth?

Background

Boarding homes provide meals and sleeping accommodations for several different populations in Kentucky. Students and construction workers rely on boarding homes for temporary housing while they are away from their permanent residences. However, many elderly persons, former mental patients, and low-income persons depend on low-cost boarding homes for permanent housing. Boarding homes in Kentucky are not subject to licensing or regulation by a state agency. Local fire departments enforce the fire safety code and local housing departments enforce the state building code. Health departments inspect boarding homes for sanitary conditions in a few local jurisdictions, but, since there is no statutory requirement to do so, the actual inspection of boarding homes varies throughout the Commonwealth. As no agency is charged with this responsibility, the exact number and location of boarding homes in Kentucky is unknown.

The discovery in a Louisville boarding house of an elderly resident who had died of bedsore infections was a cause of much concern. Fears that others may be neglected in similar situations and awareness that many frail elderly living on social security benefits reside in boarding homes has led a task force studying boarding homes in Kentucky to call for the statewide licensing and regulation of boarding homes. The Department for Human Resources has subsequently stated that boarding homes should be regulated by local health departments instead of being licensed by the state. As a result, legislation is now being considered that would require boarding homes to register with local or district health departments, pay a $25 registration fee, and submit to inspection for sanitary conditions. The question of regulation of boarding homes may be before the 1982 General Assembly.

District Health Department Board Composition

Issue

Should the General Assembly by statute determine the composition of district health department boards, or should the composition be determined by the Secretary for Human Resources via administrative regulation?

Background

A major objective of the Secretary for Human Resources is the establishment throughout the Commonwealth of a greater number of district health departments. District health departments are formed by the joining together of local health departments, subject to fiscal court approval (KRS 212.850). Local and district health departments are governed by boards with powers and duties prescribed by state law.

The Secretary for Human Resources, under KRS 211.090, is provided the authority to appoint local and district health department boards. However, while there is a specific statutory provision (KRS 212.020) setting forth the fixed composition of 7-member local boards of health, no corresponding statute exists which would provide for the composition of district boards of health.

The composition of district health boards has been previously set forth by departmental administrative regulation (902 KAR 8:010), which mandated board composition to include all local board members. The result has been large, unwieldy district health boards. To correct this problem, amendments to 902 KAR 8:010 have been proposed. District health board composition would change from a 7-per-county fixed number of statutorily specified officials or representatives of groups or professions to a district health board representing certain entities varying numerically by county, based on population. The question remains whether, in the absence of specific statutory provisions for district health board composition, the prerogative exists for the Secretary for Human Resources to modify district board composition by administrative regulation.

Finally, should the determination of district health board composition rest with an executive agency or with the General Assembly? Subsidiary issues include: Should each county have an equal number of representatives on district health boards? What officials or representatives of groups or professions should comprise district health boards, and in what proportion? What proportion of district health board members should be locally appointed? What proportion should be locally nominated with subsequent appointment by the Secretary for Human Resources?

Highways and Traffic Safety

CERTIFICATE OF TITLE FOR MOTOR VEHICLES

Prepared by James R. Roberts

Issue

Should the General Assembly adopt a certificate of title law for motor vehicles and, if so, what provisions should the law require?

Background

The General Assembly will face the motor vehicle title issue in the 1982 session. During the previous session the Senate passed legislation on the issue, but the bill failed in the House of Representatives by two votes. Since that time, several legislative committees have expressed interest in this issue and a bill has been prefiled and assigned to the Interim Joint Committee on Transportation.

Kentucky is currently the only state without specific title legislation. The title document in Kentucky is incorporated on the registration document. The ease of obtaining a proper title allows legitimate registration of stolen vehicles, which can then be sold in the marketplace. For this reason, Kentucky is being perceived as a "dumping ground" for stolen vehicles.

Discussion

The title law has been a controversial issue in Kentucky over the last two decades. The opponents of title legislation have presented several reasons for not adopting title legislation, while title proponents have disagreed on several key points to be contained within a title law.

Opponents of title legislation believe document control can be obtained without instituting separate title legislation. Better inventory control could be achieved through the reporting of documents currently being issued and by the surrendering of old titles to Frankfort for a check to determine whether a vehicle is stolen. Senate Bill 381, passed during the 1980 session, required the surrendered titles to be returned to Frankfort and has achieved some positive results in recovering stolen vehicles and uncovering some practices in violation of the consumer protection laws. Additional administrative changes are perceived to solve some of the problems raised by title advocates. Stricter document control rather than new legislation is one recommended solution.

The opponents of title legislation also raise the issue of the state's taking authority, responsibility and funds from the local government through the adoption of title legislation. A title law would require the filing of liens in Frankfort. The county clerks currently have that responsibility and receive a fee for that activity. The centralization of the title process in Frankfort would eliminate the clerk's duties and thus his fee. Should part of the fee be returned to the clerk from the title process in Frankfort, the clerk would be paid for a function in which he is not involved.

A final argument made against title legislation is that it does not prevent vehicles from being stolen. The legislation is designed primarily to prevent stolen vehicles from becoming properly registered and legitimately sold. Opponents to title legislation believe that a stringent title law can actually promote theft in a state. Their theory is that states with less stringent laws are depositories for stolen cars; therefore, it is more likely that organized car theft rings would look to border states for cars and to the state with lax title laws for re-registration. This theory has not been examined statistically for validity, but those who oppose title believe that enactment of the legislation could increase the theft rate.

Proponents of certificate of title laws believe that auto theft is a national problem and cannot be solved by actions of individual states. But since Kentucky is the only state without specific title legislation and is therefore the weakest link in the law enforcement chain, it is anticipated that the passage of title legislation would strengthen the nation's battle to recover stolen vehicles.

The title legislation supporters acknowledge some of the opposing viewpoints. The transfer of the title function to the state should not affect local revenue, and the control of the document could be better; however, the title legislation offers the best and quickest method for relief of the stolen vehicle problem, in their viewpoint.

The acknowledging of the criticisms of title legislation has led to further disagreement over the text of the bills introduced. One element of the title legislation issue is the method by which titles should be issued. During these debates four basic issues emerged:

(1) manual versus computerized registration;

(2) central or local issuance of title;

(3) method perfecting liens on titles; and

(4) enactment of non-uniform or model legislation.

These issues must be reviewed and some consensus prevail before passage of title legislation can be achieved. In addition, such issues as cost of the title document, issuance of titles for rebuilt vehicles, time period before title is issued, and the recipient of the original certificate have arisen.

The General Assembly is confronted with two issues in reviewing certificate of title legislation on motor vehicles. The first issue is whether Kentucky needs to adopt certificate of title legislation. If this question is answered in the affirmative, the form the legislation should take must then be established.

LEGISLATIVE INPUT IN ROAD CONSTRUCTION PROGRAMS

Prepared by James R. Roberts

Issue

Should the General Assembly become involved in the formulation of road construction priorities?

Background

Historically, the General Assembly has adopted a budget for the Bureau of Highways but has had very little say as to how funds were to be expended. In the absence of any structured avenue for input, general practice has been that individual members, as well as local officials, would lobby the Governor and the Highway Department for projects within their areas. The result has sometimes been that roads were constructed based on political consideration rather than need. In addition, allegations have been made that the department has initiated studies, plans or designs of projects, never to be built, largely to satisfy their advocates.

Recently a construction plan was developed by the Department of Transportation. This plan enabled local legislators and other officials to examine projects in their areas being proposed by the current administration. Two reservations surfaced from the plan established by the Bureau of Highways.

The first concern was that most locally elected officials felt they had little input on project selection. Local residents may have better understanding of area needs and should be given opportunity to express their wishes.

The second issue was that the five-year plan established by the department did not have any guarantee of being fulfilled. The term of a Governor lasts just four years. Traditionally, plans and projects to be completed by one administration are set aside with the election of a successor. Thus, the road construction program suffers lack of continuity between administrations. For these reasons, the General Assembly has undertaken an examination of methods which might make its members and the public more aware of road fund expenditures and provide continuity to the Bureau of Highways Program.

Discussion

In 1968, the Louisiana Department of Transportation established a five-year plan for road construction. The initial plan was either too ambitious or was amended to the point that, by 1974, projects listed in the first years were yet to be completed. The Louisiana legislature became concerned with the credibility and performance of the department, and began looking for an alternative.

In 1974, the Louisiana legislature passed a law requiring the highway department to provide a list of construction priorities for the ensuing fiscal year. The Legislative Committee on Transportation now conducts public hearings of such proposals and may recommend changes to the highway department to be incorporated into a final draft. This document is then returned to the legislature for final approval, prior to a vote on the highway budget.

The Louisiana statute has been in effect approximately seven years. The advocates of the program see several advantages for the Department of Transportation, the General Assembly and the public.

The department is planning more effectively. Examinations of the roads by the professional staff have become more meaningful. Loss of time in planning due to the shuffling of priorities has been eliminated. Roads for which planning, design and right-of-way funds are expended will eventually be constructed.

The legislature has obtained better knowledge of the department's problems. As a result, related legislation has been more insightful and lines of communication between the department and the legislature are more open. Finally, the individual legislator knows the program which is being proposed and can make better decisions regarding funding increases for the highway program.

The public is also involved in the process through the public hearing. Their views can be made known and the citizens become more aware of total highway needs and funding constraints. The entire process results in a coordinated effort, greater understanding of needs, and legislative and citizen review of highway department activity.

Opponents of the legislation cite some disadvantages of the program. Additional personnel are needed to perform required functions, which means greater costs. Since the program is continuous the costs are incurred annually. The hearing requirements also crowd the program development calendar and place a travel burden on department personnel and legislators.

The greatest objection is that the Department of Transportation does not have the flexibility to respond to needs as they arise. The program binds the department, thereby limiting its effectiveness.

The General Assembly, in order to implement a required program of expenditures, must decide whether the department's flexibility would be hampered to the extent that legislative and public review would reduce the efficiencies which the Department of Transportation has currently achieved.

RAIL ABANDONMENT AND DEVELOPMENT

Prepared by James Monsour

Issue

Should the state assist local communities in the retention and improvement of rail services?

Background

In 1978, the General Assembly appropriated $1.1 million for a Rail Development Program to be administered by the Kentucky Department of Transportation during the 1978-80 biennium. Funds were initially used to match federal money in developing a state rail plan, which identified maintenance needs on light density rail lines in danger of being abandoned by the railroad companies as unprofitable. After the review and approval of the plan by the Federal Railroad Administration, the state could make application for federal matching money to rehabilitate the specified lines, thus enhancing their profitability and perpetuating rail service in the affected communities.

The state rail plan and its 1979 update identified more than a dozen rail lines throughout the state that had either been approved for abandonment, had a petition for abandonment before the Interstate Commerce Commission or were under study by the railroads and proposed for abandonment. Because the capital expenditures required to rehabilitate all these lines exceeded available federal and state monies, six projects were chosen for rail service continuation assistance. The list of eligible projects was shortened further, however, since participation required local communities to provide 20% of the project costs, and a portion of operating expenses thereafter.

By 1980, approximately $175,000 of the $1.1 million state appropriation had been expended, chiefly on the administration of the program. The balance, as well as $2 million in federal funds, allocated at a rate of $1 million per year after approval of the rail plan, remained available for rail service assistance projects. At that time, one project, the rehabilitation of the Lebanon to Kane line, which runs through Campbellsville, became the program's top priority, after it was determined that the parties involved in the project - namely, the railroad, the City of Campbellsville, the state, and the Federal Railroad Administration - would each bear a portion of the project costs, and that the rehabilitation of the line would stimulate the economy of the affected area, thus justifying the expenditure.

Late in 1980, however, the railroad withdrew its support, placing a larger burden of the funding on the local government. This situation, coupled with the Kentucky Department of Transportation's abolishment of the Division of Rail Services, which was responsible for the Rail Development Program, left the project's future in jeopardy. Meanwhile, the abandonment of light density rail lines continues. Recently granted petitions filed with the ICC on behalf of two railroads, for example, have resulted in the loss of rail service in Benton and several communities in the Purchase Area Development District. Abandonment actions in the near future not only threaten rail service in Campbellsville, but could also curtail rail transportation in as many as twenty counties.

Discussion

Two developments, the abolition of the Division of Rail Services and the Reagan administration's budget, which would effectively end federal subsidies for rail service continuation, have made the retention of rail service a growing problem for Kentucky's smaller communities, especially in the areas of Western and South Central Kentucky, which rely heavily on railroads to move agricultural and industrial commodities. In light of these developments, federal legislation designed to promote existing rail services or alternative means of financing for both the improvement and operation of light density lines, offers the best solutions to those shippers and communities facing the loss of rail service.

The Staggers Rail Act, passed by Congress in October, 1980, serves to further deregulate the rail industry, by providing the mechanism whereby railroads are allowed more flexible rate formulation agreements with shippers and can more easily merge or consolidate services. Shippers and railroad companies may now enter into contracts for continued services, with the railroad fixing the rates and the user guaranteeing a specified volume of traffic, or, in the event he cannot, agreeing to surcharges scaled to traffic volume levels. In addition, shippers, localities or the state may purchase light density lines, if the majority of the shippers feel they are receiving inadequate service or it can be shown it is in the public interest that they do so.

In three Midwestern states, the extent of rail abandonments has resulted in the creation of Railway Financing Authorities, whose function it is to: (1) provide the legal means to transfer ownership and control of privately owned rail lines to the state when such lines are abandoned; and (2) insure that monies are available to operate and maintain these lines. Railway Finance Authorities in Iowa, and in North and South Dakota may issue bonds to acquire railroads by purchase or lease, enter into contracts for the operation and management of railroad facilities, and fix rates and fees for the use of railroad facilities.

In view of the fact that the further erosion of the state's in-place rail transportation system is imminent and that continued abandonments may permanently affect the future growth and economic health of many Kentucky communities, the legislature needs to consider whether a state subsidized or supported rail service continuation program is warranted.

OTHER ISSUES RELATING TO TRANSPORTATION

Railroad Safety

Issue

Should the state participate in a rail safety program in conjunction with the Federal Railroad Administration?

Background

The serious nature of train derailments, as well as the increased frequency of their occurrence in Kentucky in recent times, focuses attention on railroad safety. The state's role in rail safety programs, however, remains minimal, although federal monies have been available for the investigation and surveillance of railroad lines and equipment since 1970.

Currently, the federal government employs four persons in the three-state region of Kentucky, Tennessee and West Virginia, who are responsible for track and equipment inspections. In addition, as a result of the Federal Railroad Safety Act of 1970, monies are made available to the states on a matching basis, to subsidize the employment of state track inspectors and the purchase of automated inspection equipment. State inspection programs, to be eligible for federal funds, must be approved and certified by the Federal Railroad Administration.

In order to achieve certification, the state must provide an agency with regulatory jurisdiction over safety, adopt federal safety rules and regulations, and conduct investigations prescribed by the federal government as necessary. State inspectors must be trained and certified in order for the state program to be approved. Until 1978, responsibility for the administration of a state rail safety program resided solely with the Kentucky Railroad Commission. Owing to severe budget constraints, however, the Railroad Commission was never able to undertake a safety program. In 1978, therefore, responsibility for the development of a rail safety program was transferred to the Department of Transportation, when the Division of Rail Services was created by Executive Order. Subsequently, the division was unable to implement a rail safety program, because of the difficulty in hiring inspectors. With the election of a new administration, the division was abolished.

Tax Credits for Public Transportation Companies

Issue

Should the state modify its present method of collecting motor fuels taxes levied on public transportation companies, in order to provide greater operating assistance to these firms, in lieu of providing direct assistance?

Background

In the past decade public transportation companies, especially those operating in Kentucky's urban areas, have relied greatly on federal subsidies in order to afford capital improvements and continue operations. Legislation proposed by the Reagan administration, however, would eliminate federal assistance by Fiscal Year 1985, with reductions from current levels in 1983 and 1984. Since increased subsidies from the state are unlikely, due to the current decline in Transportation Fund receipts, and neither fare box revenues nor existing local taxes can adequately support local public transportation services, exemption from the motor fuels tax, if adopted, would provide a substantial benefit to future transit operations in Kentucky's cities, especially in Covington, Lexington and Louisville.

Presently, existing statutes levy a nine percent per gallon state tax on gasoline and motor fuels purchases and allow a refund of 7/9ths of this amount for public transit vehicles, private bus operations and taxicab companies. The paperwork required to obtain the refund, however, is cumbersome and involves long delays. In order to provide operating assistance to local transit systems without providing a direct subsidy, the state might wish to consider modifying existing tax collection methods, thereby decreasing transit operating costs. The public transportation sector has recommended that the General Assembly, to accomplish this, exempt public transportation vehicles from KRS 138.220, which levies a 9 percent per gallon gasoline tax on motor fuels purchases, rather than refunding 7/9ths of the tax under the cumbersome process presently provided in KRS 138.662.

Child Passenger Restraint Systems

Issue

Should the General Assembly adopt a mandatory child passenger restraint law?

Discussion

Several states have recently adopted laws on child passenger protection. In most cases, the law requires that a child under a certain age be placed in an approved car seat while being transported in a motor vehicle. Automobile accidents are a major cause of death in children under 12 years old. Proponents of the legislation believe that a law requiring child protection would significantly reduce the death rate.

Opponents of mandatory restraint believe the laws are difficult to enforce, that compliance with the law cannot be achieved. Tennessee, the first state to pass a protection law, has only a 30% compliance rate. This fact, coupled with the provision that only the parent or guardian is required to comply, makes the law difficult to enforce.

Non-Utilization of State-Owned Property By the Kentucky Department of Transportation

Issue

Should the Department of Transportation, which holds title to considerable real property that has never been utilized, sell the land?

Background

Condemnation of land for highway projects which were never built or which did not utilize the entire acquired parcel has resulted in a large inventory of real estate at the Kentucky Department of Transportation. Many prior owners of this land and adjacent landowners as well, would prefer the land be sold as surplus property in order to better utilize the parcels. The Kentucky DOT agrees that surplus property could be sold, but statutory guidelines for disposal could restrict the highway construction program in the future. In addition, the reacquisition of right-of-way for rescheduled projects would likely be more expensive than the original purchases were.

Judiciary

USE OF COMMISSIONERS IN DOMESTIC RELATIONS CASES

Prepared by Edith Schwab

Issue

Should domestic relations commissioners appointed by the circuit judge be permitted to hear domestic relations cases in circuit court, and should the commissioner be paid for his services by the parties in the action?

Background

The report of the Administrative Office of the Courts to the Interim Joint Committee on Judiciary indicates that of the fifty-eight judicial circuits, there are eight in which domestic relations cases of all types are regularly referred to commissioners. There are sixteen other circuits in which some duties respecting domestic relations cases are performed by commissioners.

Legislators have indicated that they have received numerous complaints from constituents about the use of commissioners in domestic relations cases. In those counties in which domestic relations commissioners are being used, the commissioner sets the fee, so that the fee varies from county to county. Many persons find the practice in some counties of paying the commissioner "over the bench" particularly objectionable.

In those counties where the circuit judges hear the domestic relations cases, the parties to the action incur no additional expense, as the judges receive their salaries from the state.

Discussion

The use of domestic relations commissioners undoubtedly reduces the workload of the circuit judges. It also helps the constituents to have their cases heard more quickly. On the other hand, many persons feel that domestic relations cases merit the attention of a judge chosen by the people rather than a commissioner whom the judge appoints. Also, many feel that the cost of the action should not vary from county to county, depending on whether commissioners are being used and, where they are used, on how much the commissioner charges.

The Supreme Court has indicated that it intends to phase out the use of commissioners in domestic relations cases. This is a delicate issue, since the Constitution grants to the Supreme Court the right to make its own rules relating to practice and procedure. If the General Assembly chooses to enact legislation in this area, it will have to be drafted in such a way that the General Assembly does not infringe on the Court's rule-making power.

MANDATORY SENTENCING

Prepared by Norman W. Lawson, Jr.

Issue

Should the General Assembly expand present legislation specifying mandatory prison terms without probation, by increasing the number of offenses to which it applies, or by prohibiting parole and other forms of early release as well?

Background

Present legislation provides that probation is not allowed for Class A, B, or C felonies committed with firearms. Thus, a jail sentence is mandatory. Legislation has been proposed which would prohibit parole or set a mandatory term which would have to be served before parole for offenses involving drugs, marijuana, firearms, and crimes against the elderly.

Discussion

Proponents of the legislation say that it is necessary, to prevent dangerous criminals from being released before they have served a sufficient amount of time in prison. They cite heavy recidivism or social needs (e.g., protection of the elderly) as the basis for separating these classes of offenders from society for longer periods of time. They generally feel that the parole system has been inadequate and that it does not keep dangerous offenders in prison long enough.

Opponents of the legislation say that the parole system is working properly, that dangerous criminals presently serve longer than others, that the system of mandatory incarceration creates a prisoner less amenable to rehabilitation, and removes the discretion that the parole board needs to properly function. They also cite expense as a factor and postulate that the prison population will increase.

In the event that prison populations increase, Kentucky, in particular, will have a problem, since it is under federal mandate to limit the number of persons incarcerated in the present prison facilities. If this type of legislation is passed, other criminals might have to be released to make room for the mandatory sentencees, or new facilities will have to be built or acquired.

The matter has been discussed in general by the Interim Committee on Judiciary, but as of this writing there is no specific bill draft which has been approved or prefiled by the committee.

Labor and Industry

UNEMPLOYMENT COMPENSATION

Prepared by Linda Bussell and Stephen Harbison

Issue

What changes are necessary in the unemployment compensation program to guarantee payment of benefits and improve the financial status of the unemployment compensation trust fund?

Background

The unemployment compensation system in this country has been in existence since 1935 and was designed to provide benefits to workers who become unemployed through no fault of their own. The unemployment compensation system is a unique federal-state relationship which is based on federal law but administered, in its relationship to employers and unemployed workers, through state law and by state employes.

The Social Security Act (SSA) and the Federal Unemployment Tax Act (FUTA) established the framework for the unemployment compensation system.

Under the provisions of the Internal Revenue Code, a federal payroll tax of 3.4 percent is levied on salaries up to $6,000, paid by covered employers. However, the law provides a credit of 2.7 percent against the federal tax to employers who pay state unemployment compensation taxes under an approved state program. All states now have an approved unemployment compensation program and the effective federal tax rate is .7 percent.

The federal tax is used to pay all state and federal administrative costs of the unemployment compensation system, to pay fifty percent of extended benefits granted during times of high unemployment, and to maintain a federal trust fund from which an individual state may borrow whenever it lacks funds to pay unemployment compensation benefits.

Except in a few states where there are small employe contributions, the unemployment compensation system is financed by a payroll tax on employers.

Kentucky's unemployment compensation program has been in effect since 1939 and is administered by the Department for Human Resources. Unemployment compensation benefits paid to eligible unemployed workers are financed through a tax imposed on employers covered under the unemployment compensation law. The state unemployment compensation tax is applied to the first $6,000 of wages paid to each employe and is paid in addition to the federal tax. Most covered employers pay their taxes quarterly and the money is deposited in the state trust fund. Nonprofit organizations and public employers may elect to make payments in lieu of contributions to the state trust fund. Employers who elect to make payments in lieu of contributions are called reimbursing employers and are required to make quarterly reimbursement for benefit charges against them.

The tax bill of an employer is based on his experience rating and on the financial status of the state trust fund. There are eight statutory tax rate schedules; the tax schedule in effect at a given time depends on the trust fund solvency factor. It the fund is insolvent, the tax schedule with the highest rates becomes effective. The particular tax rate on the applicable schedule assigned to an employer depends on the employer's reserve ratio, which is determined by the amount of taxes collected from and the amount of benefits paid out by an employer.

Unemployed workers who meet the statutory eligibility requirements may receive benefits for a maximum of thirty-nine weeks. Regular unemployment compensation benefits are paid for a maximum of twenty-six weeks and, in periods of high unemployment, an unemployed worker may receive extended benefits for an additional thirteen weeks. Extended benefits are now payable in Kentucky. The maximum weekly benefit amount, calculated on July 1 of each year, is fifty-five percent of the state average weekly wage. The current maximum weekly benefit amount is $139.00.

In 1980, Kentucky had its highest unemployment rate since the unemployment compensation program was established. The state collected $163 million in unemployment compensation taxes, but it paid out $284 million in benefits. It was the second of two successive years in which benefit disbursements exceeded the taxes collected. For the first time since 1939, the state trust fund has become insolvent, forcing the state to borrow money from the federal government to make benefit payments. The Department for Human Resources has borrowed $50 million for the first half of 1981 and expects to borrow an additional $125 million to make benefit payments through 1982.

Officials in the Department for Human Resources point out that another reason for the bankrupt condition of Kentucky's trust fund is that unemployment benefits are increased annually as the state average weekly wage increases, but the unemployment compensation taxable wage base is increased only by legislative action.

Discussion

The 1982 General Assembly will have the difficult task of making revisions in the unemployment compensation program to improve the financial status of the trust fund and to ensure the payment of benefits to unemployed workers.

The Department for Human Resources has presented three major options with projected revenue estimates for consideration: (1) borrowing from the federal trust fund; (2) restructuring the benefit provisions; and (3) revising the tax structure. Each option is briefly discussed below:

Borrowing From the Federal Trust Fund. The most obvious option available to the state, which will result in an immediate increase in income to the state trust fund, is to continue borrowing from the federal trust fund beyond 1982. Currently, approximately twenty-seven states have borrowed from the federal trust fund. However, such borrowing should not be considered an easy way out of the financial straits many state trust funds are in. The federal government has imposed repayment procedures on the federal loans. The penalty for failing to repay the federal loan within the prescribed time period is a reduction in the federal tax credit granted to employers. For example, if Kentucky does not repay the money it borrowed in 1981 by January of 1984, the federal tax credit to employers will be reduced by .3 percent. The federal tax credit will continue to be reduced by .3 percent each year until the full amount of the federal loan has been repaid or until the full tax credit is removed. If the federal tax credit is removed, employers will pay a federal tax of 3.4 percent rather than the .7 percent they currently pay. Repayment of the federal loan will be shared equally by the employers in the state because the federal tax is not based on experience rating. Moreover, how long states will be permitted to continue borrowing from the federal trust fund is uncertain. The federal government has, at this point, extended loans to states exceeding $5.5 billion and there are reports that the federal trust fund may be bankrupt in the next two years. Also, Congress is considering legislation which will tighten up the borrowing and repayment of loans from the federal trust fund. There has also been speculation that Congress will enact legislation which will require states to pay interest on federal loans.

Restructuring Benefit Provisions. The following benefit options were suggested by the Department for Human Resources:

1) Institute a one-week waiting period.

   Currently, unemployed workers in Kentucky are eligible for unemployment compensation benefits for the first week of unemployment. The inclusion of a one-week waiting period would reduce the duration of benefits and would result in an estimated annual savings of approximately $12 million. Also, Congress enacted legislation in 1980 which prohibits the payment of the federal share of the first week of extended benefits to any state which does not have a provision for a waiting week in its program.

2) Cap the maximum weekly benefit amount at 55 percent of the state average weekly wage as of July 1, 1981.

   Unemployment compensation benefits are indexed to the state average weekly wage, which results in an automatic annual increase in benefits. Placing a cap on the weekly benefit amount would remove the indexing of benefits to wage inflation and would result in an estimated savings of approximately $21 million.

3) Reduce the maximum weekly benefit from 55 percent to 50 percent of the state average weekly wage.

   This option would simply reduce the maximum weekly benefit amount and would result in an estimated annual savings of approximately $8 million.

4) Change the formula for calculating the weekly benefit amount from 1/23 of an unemployed worker's high quarter wages to one percent of his total base period wages.

   This would decrease the number of claimants receiving the maximum weekly benefit and would reduce the weekly benefits of seasonal workers whose earnings are concentrated in one quarter. The estimated annual savings of this option is $7 million.

5) Reduce the maximum duration of benefits from 26 to 24 weeks.

   According to the Department for Human Resources, the average duration of an unemployment compensation claim is 15 weeks; therefore, reducing the maximum duration from 26 weeks to 24 weeks would not impose a severe hardship on unemployed workers. This option would result in an estimated annual savings of $5 million and would not affect the extended benefit period.

Revising Tax Structure. The Department for Human Resources has suggested the following tax options:

1) Increase the taxable wage base from $6,000 to 75 percent of the state average annual wage reduced to the nearest multiple of $1,000.

   Under this option, which indexes taxes to wage inflation, the taxable wage base for 1982 would be $9,000 and would generate approximately $55 million, or a 34 percent revenue increase from 1980. Indexing the taxable wage base to the state average annual wage will not only generate additional tax revenue but it has the potential of providing a more equitable distribution of tax liability. Under the current system, employes earning $6,000 have their total wages taxed, while employes earning $2,000 have 50 percent of their wages taxed. The argument has been made that the present system places a disproportionate share of the total tax burden on small employers.

2) Revise current tax structure to shift more of the tax burden to employers with poor experience ratings.

   Under this option, the seven existing tax schedules would be replaced with five revised schedules. Approximately one-third of the 61,000 covered employers would receive a tax reduction. The remaining employers would receive a tax increase; however, the largest increases would be imposed on employers with negative reserve account balances. According to the Department for Human Resources, approximately 10,000 employers have negative reserve account balances, and in 1980 these employers accounted for approximately 68 percent of the total amount disbursed for unemployment compensation benefits. The revised tax schedules would generate an estimated $97 million revenue increase over 1980.

3) Impose a surtax when the unemployment insurance trust fund balance falls below $100 million.

   The surtax, which would not exceed one percent of the wages above the taxable wage base, would generate an estimated increase of $45 million, assuming that the surtax were applied to one of the revised rate schedules.

It should be noted that this list of options does not exhaust all possibilities, nor are the terms of the options inviolable. For example, the taxable wage base could be raised to some arbitrary amount, such as $10,000, or to some other percentage of the average annual wage. Revenue estimates could be made for an array of alternative numbers. Because of the bankrupt condition of the state trust fund, the 1982 General Assembly will probably consider legislation to raise the taxable wage base, increase employer tax rates, or control the level of benefits. Such legislative changes appear necessary to ensure the payment of benefits to unemployed workers in Kentucky.

WORKERS' COMPENSATION

Prepared by Linda Bussell

Issue

Should the 1982 General Assembly adopt the recommendations of the recently completed workers' compensation study and should the legislature establish an alternative method of financing the workers' compensation special fund?

Background

During the past decade, workers' compensation has been a highly controversial issue in many state legislatures. The rising cost of the workers' compensation program has been an important legislative issue during the past several sessions of the Kentucky General Assembly. During the 1980 session, the General Assembly mandated a 27% reduction of workers' compensation rates for a one-year period; increased the maximum weekly benefit amount for permanent partial disability, but reduced the duration from life to 425 weeks; increased the maximum weekly benefit amount for permanent, total disability; expanded the provisions and increased the benefits for rehabilitation; and abolished the coal worker's pneumoconiosis fund. The 1980 General Assembly also adopted a resolution which directed that a comprehensive study be made of the workers' compensation program in Kentucky. The findings of the study were released in June.

Workers' compensation laws have been in effect since 1911 and workers' compensation protection is compulsory for most employes in most states. The purpose of workers' compensation is to provide medical and cash benefits to workers who are injured during the course of their employment.

The following options are available to employers for providing workers' compensation coverage for their employes: private insurance, self-insurance and state fund. Kentucky employers maintain the required coverage through private insurance and self-insurance.

The majority of employers in Kentucky maintain the required coverage through the private insurance market. Workers' compensation insurance premiums are determined by a rating system developed by the National Council on Compensation Insurance (NCCI), a rating and statistical organization for approximately five hundred insurance companies nationwide. NCCI is the licensed ratemaking organization in thirty-two states.

Although most employers in Kentucky provide workers' compensation coverage through the private insurance market, many employers provide coverage through self-insurance. An employer may qualify as a self-insured employer if he can demonstrate an ability to pay the benefits mandated by the workers' compensation law. In Kentucky, there are 210 self-insured employers. Also, approximately 556 employers are self-insured through membership in eight self-insurance groups. Since 1978, two or more employers have been permitted to pool their liabilities for purposes of group self-insurance.

In addition to the workers' compensation premiums, privately insured employers and self-insured employers are required to pay a tax and assessment charge for workers' compensation. During the past year, the tax and assessment charge has become a controversial item, since the tax and assessment charge on insurance policies increased in July, 1980, from 8.91 percent to 16.68 percent.

The tax and assessment charge covers contributions required by employers for the special fund. The special fund pays second-injury and occupational disease claims.

According to estimates provided by the executive branch, the following is a breakdown of how the average tax and assessment dollar was made up during the twelve months that ended July 1, 1981:

12 cents	-	allotted to the Department of Labor for administrative costs, including those of the workers' compensation board and a portion of the Kentucky occupational safety and health compliance program.
4 1/2 cents	-	allotted to the special fund for basic operating costs.
2 cents	-	allotted to the insurance carrier or its agent for the cost of collecting the taxes.
50 cents	-	allotted toward the payment of weekly benefits to workers who have an occupational disease (although most of these occupational diseases are "black lung," other occupational diseases are included).
31 1/2 cents	-	allotted to the special fund to pay benefits to workers who have received "second injuries."

Prior to 1976, the tax and assessment charge was included in the workers' compensation insurance premium. During the 1976 Extraordinary Session of the General Assembly, legislation was enacted which separated the tax and assessment charge from the workers' compensation premium. Because of this separation, the tax and assessment charge has become more visible to employers, and increases in the tax and assessment charge have become highly controversial.

There are many who assume that the major revisions made in the workers' compensation law by the 1980 General Assembly are responsible for the large increase in the tax and assessment charge during the past year. According to the Department of Insurance, the only real effect the 1980 workers' compensation legislation had on the tax and assessment charge resulted from the 33 percent reduction in workers' compensation premiums. Since workers' compensation premiums were reduced by approximately 33 percent, adjustments in the tax and assessment charge will be needed, to produce the necessary amount of revenue on a lower premium.

The Department of Revenue is responsible for calculating the percentage charged to employers for taxes and assessments. The tax and assessment charge is determined by the number of successful claims filed against the special fund. According to the Department of Insurance, the previous tax and assessment rate of 8.91 percent that insurance companies had been charging was an estimated percentage figured by the insurance companies themselves and it has been inadequate for the last three years. It has thus been claimed that employers received an estimated $6 million windfall in the tax and assessment charge from July 1, 1978 to July 1, 1980.

The tax and assessment charge will increase as the liability of the special fund is increased. For the fiscal year ending June 30, 1981, the liability of the special fund was $44.3 million. According to the Department of Labor, the liability of the special fund is expected to exceed $55 million for the fiscal year ending June 30, 1982.

Discussion

The 1980 General Assembly made significant changes in the workers' compensation program and these changes resulted in an estimated savings of approximately $100 million to employers in Kentucky. However, the tax and assessment charge levied on employers and dictated by the liability of the special fund has increased significantly during the past year. The financing of the special fund has been a source of controversy for several years and the 1982 General Assembly will have the complex task of reviewing the current financing methods and considering an alternative financing method that will generate sufficient revenue to cover the liability of the special fund.

The 1982 General Assembly will also review the recommendations of the recently completed study of the workers' compensation program. The study was conducted by Tillinghast, Nelson and Warren, as a result of House Joint Resolution 24, adopted by the 1980 General Assembly. Several recommendations were made in the final report of the study. Two major recommendations were:

- That Kentucky consider adopting a competitive rating system that would stimulate direct price competition among insurance companies. A single rate system is currently in existence in Kentucky and this single rate is charged by all insurance companies. A competitive rating system in Kentucky would allow each insurance carrier to set its own rates, which would be regulated by the Department of Insurance. The Minnesota legislature has recently adopted a competitive rating system for workers' compensation, and several other states are considering competitive rating, in an effort to promote greater competition in workers' compensation insurance rates.

- That the workers' compensation special fund be replaced with a non-profit reinsurance fund, as a long-range solution to financing the liability of the special fund. The reinsurance fund would be mandatory for all employers and would be administered by representatives of employers, employes and insurance companies. State government would have an oversight role over the operation of the reinsurance fund.

The Executive Branch has observed that adoption of the major recommendations made in the workers' compensation study could result in significant savings and improvements in the workers' compensation system. However, Governor Brown has said that, as a result of the recommendations made in the study, he plans to meet with legislators and representatives of labor and business before recommending any further changes in the workers' compensation law.

PREVAILING WAGE

Prepared by Jean Keene

Issue

Should Kentucky's Prevailing Wage Law be repealed?

Background

The Davis-Bacon Act, passed by Congress in 1931, requires contracts for federally financed or assisted construction costing over $2,000 to contain a provision stating the prevailing hourly wage rate to be paid the various classes of laborers or mechanics. Wage determinations are made by the Secretary of Labor, based on an evaluation of prevailing wages for the corresponding classes of workers on similar projects contracted in the area where the work is to be performed. In 1964, an amendment modernized the Act by requiring that the fringe benefits presently common to the construction industry as a whole be available to all employes under the contract.

Before the passage of Davis-Bacon, seven states had prevailing wage laws of their own, Kansas being the first, having passed such a law in 1891. Today, thirty-seven states, including Kentucky, have "little Davis-Bacon Acts." In the case where a state or local construction project is federally assisted, it may be subject to separate state and federal prevailing wage determinations. When these two rates differ, the higher wage must be paid to each classification involved.

Although federal and state wage determination methods and project coverage may differ, the purpose for all prevailing wage laws is the same: to protect local workers and contractors from itinerant contractors who hire cheap labor from outside the area. The prevailing wage laws were designed to give local labor and contractors a fair opportunity. Recently, however, the question of whether the desired purpose is being achieved has been raised.

Indications are that 1982 could be a critical year for prevailing wage legislation. Although President Reagan has not come out in favor of repealing the Davis-Bacon Act, he has promised to alter the way it is administered. In 1981 thirteen states introduced legislation to repeal their prevailing wage laws. The only successful attempt was in Utah, where the governor's veto was overriden. In 1981, Arizona's law was declared unconstitutional when the state Supreme Court let an appellate court decision stand that invalidated the rate determination methodology which mandated the sole use of collective bargaining rates. Alabama and Florida repealed their prevailing wage laws in 1979 and 1980 respectively. Several unsuccessful attempts were made during the 1980 legislative session to amend the Kentucky prevailing wage law. However, a resolution was adopted which directed the Legislative Research Commission to study the economic impact of Kentucky's prevailing wage law. To gather information for this study, the Capital Construction Review Committee held hearings to allow the public to voice their views on the law. Testimony was heard from school boards, universities, chambers of commerce and various other organizations. The study will be completed late in the summer of 1981.

Kentucky's prevailing wage law was originally enacted in 1940. At that time, the public authority issuing a contract was required to establish the prevailing wage for laborers, workmen, and mechanics on each project performed. Our current prevailing wage law has been in effect since 1960 and the Commissioner of Labor has the responsibility of making initial determinations, which are reviewed by the Prevailing Wage Board.

Before advertising for bids or entering into a contract for construction of public works costing over $500, every public authority must notify the Department of Labor, in writing, of the work to be done and request the prevailing wages and fringe benefits for each classification of laborers, workmen, and mechanics to be used on the project in the area where the work will be performed. In the event that a contract is not awarded within 90 days, the public authority must obtain a new schedule of wages from the Department of Labor. If it is found that a public authority has not followed this procedure, the Commissioner of Labor shall give written notice and grant sufficient time for compliance. If violations still occur, suit may be brought in the circuit court of the county where the authority is located.

If a contractor or subcontractor is not paying the required prevailing wage, the public authority awarding the contract may withhold the amount from the contractor and pay it directly to the workers. A contractor is then prohibited from bidding on public works until he is in compliance with this act.

In determining wage scales, the Commissioner of Labor shall consider:

(1) Wage rates on previous public work in the locality;

(2) Wage rates previously paid on reasonably comparable private construction projects in the locality; and

(3) Collective Bargaining agreements which apply to the locality where the construction is done.

The "prevailing wage rate" for each classification of workers shall be that which is paid to the majority of those workers in similar projects in the area. If a majority is not paid the same rate, then the rate paid to the greater number is said to be prevailing, provided that such rate is paid to at least 30% of those employed. If less than 30% are receiving the same rate, the average rate is used. Since union scales, which are set in collective bargaining agreements, are uniform, while non-union wages generally are not, the prevailing wage rates are often the same as union wage rates.

Discussion

The arguments for and against the Kentucky Prevailing Wage Law are the same as those for and against the federal Davis-Bacon Act. Arguments opposed to prevailing wage include the following: (1) the act came as a result of the Depression and is no longer necessary; (2) it is inflationary because it results in public works contracts costing more than other construction contracts, since labor costs are higher. This extra cost is then passed on to the taxpayers; and (3) it gives an unfair advantage to union employers over non-union employers in bidding for public works contracts. Hostility may develop in employes of an open-shop contractor if those working under a government contract are making better wages than those working on private projects.

Arguments in favor of retaining the Kentucky prevailing wage law include the following: (1) Since Kentucky's present law was passed in 1960, it is more than a Depression measure and is still needed today; moreover, some states enacted prevailing wage legislation prior to the Depression; (2) It ensures that those contractors who pay decent wages and offer decent working conditions are not disadvantaged when bidding for public works contracts; (3) It is not inflationary, since it only calls for the payment of wages already prevailing in the locality; (4) If payment of prevailing wage rates were not required, there is no guarantee that the overall cost of the construction would decrease; and (5) Paying the locally prevailing rate may make it possible to attract better trained and more highly skilled construction workers who are able to complete the job quickly and efficiently.

The 1982 General Assembly may consider several alternatives to the prevailing wage law in Kentucky. The following alternatives have been discussed by business and labor leaders, administrators and legislators:

(1) Repeal the law. The states of Utah, Alabama, and Florida recently repealed their prevailing wage laws. In Florida, however, three local prevailing wage laws were preserved by veto of a bill that would have voided them and barred future adoptions of local laws. At the federal level, four house bills were introduced in 1981 to repeal the Davis-Bacon Act.

(2) Raise the $500 coverage threshold. This would decrease the administrative burden and costs since fewer projects would be covered by the law. Nine states currently have thresholds ranging between $25,000 and $500,000.

(3) Use the arithmetic average of wages and fringe benefits in determining the wage to be paid, instead of using the current "30 percent rule." This approach would be more representative of all construction workers in the area. However, it could hardly be called "prevailing," since it would be artificial, applying to no one or only a few.

(4) Calculate different wage rates for cities and counties. In Kansas, counties containing a first or second-class city have separate prevailing wage rates for the county and city. Therefore, rural areas do not have to pay the same wages paid in the larger cities, where the cost of living is expected to be higher.

OTHER ISSUES RELATING TO LABOR AND INDUSTRY

Collective Bargaining

Issue

Should public employe collective bargaining legislation be extended to cover public employes beyond the reach of existing statutory law?

Background

According to a survey conducted by the United States Department of Labor, in 1979 in Kentucky there were 58 public sector labor-management agreements, covering almost 11,000 employes. In the past few years, some national labor unions and professional organizations have made a strong effort to organize and bargain for public employes. Despite the increasing incidence of public employe bargaining, public sector labor relations law in Kentucky has been created, for the most part, by the courts. Although public employe bargaining bills have been introduced in every regular session of the General Assembly since 1968, the only statutory law that adds to the case law is the duty-to-bargain legislation covering firefighters in Louisville and other cities electing coverage, and police in Jefferson County, passed in 1972.

In 1978, the Kentucky Supreme Court, in the landmark University of Kentucky Board of Trustees case, confirmed the constitutional right of all public employes to organize and bargain, and the inherent power of all public employers to recognize and bargain with duly elected employe representatives. Restating established case law, the Supreme Court held that public employes do not have the right to strike and that public employers are not under a "duty-to-bargain" unless directed to do so by statute. It also held that public employers do not have the authority to recognize a union as an exclusive bargaining agent.

Essentially, this is Kentucky's public sector labor relations law. There are several obvious gaps. The Supreme Court in the Board of Trustees case did not consider such issues as "appropriate bargaining units and methods of election," noting that, notwithstanding a request from the plaintiff, "the trial court wisely declined to get into this theoretical quagmire." Nevertheless, without state legislation, the courts will be forced to resolve unsettled bargaining issues. A strong possibility exists that comprehensive public sector labor relations law will inevitably emerge. The question is whether it will be made by the courts, case by case, or by the legislature.

State Government

STATE LEGISLATIVE AND CONGRESSIONAL REDISTRICTING

Prepared by Joyce Honaker

Issue

How should Kentucky's state representative, state senate and congressional districts be redrawn?

Background

Under federal and state laws, the Kentucky General Assembly has the responsibility for redrawing Kentucky's congressional and state legislative districts after each decennial census of the population. Redistricting is a major controversial issue facing the General Assembly because of its impact upon the representation of individuals, areas and groups within the state and federal legislative processes, because it affects incumbent legislators and their prospective opponents for nomination and election, and because of conflicting legal standards applicable to redistricting plans. Since the mid-1960's, when the federal judiciary accepted jurisdiction over redistricting controversies, suits testing the validity of redistricting plans against U.S. constitutional standards can be expected after a legislature (or other state redistricting body) completes its work.

A key redistricting controversy is whether a particular redistricting plan will strengthen or weaken the representation of different interests in the legislative process. On the theory that a group's or an area's interests are most adequately represented by the election of one of its number to a legislative seat, interest groups, communities, counties and regions seek placement in a district which they dominate numerically and often seek representation as a unit, as evidenced by the controversy over the splitting of counties in 1971-72 redistricting plans and the current Northern Kentucky campaign to be included in a single congressional district.

Superimposed on the political controversies concerning the redrawing of district lines are the legal standards for redistricting prescribed by federal and state constitutions, statutes and court decisions.

Under federal constitutional and statutory laws, congressional districts must be single-member districts (2 U.S.C.A. Section 2C) drawn in the manner prescribed by the legislature of each state (U.S. Constitution, Article I, Section 4). Congressional seats are apportioned to the 50 states based on population and a federally-prescribed formula, with no state receiving less than one member (U.S. Constitution, Article I, Section 2a). The 1980 Census will permit Kentucky to retain its seven congressional seats.

The U.S. Supreme Court has ruled that Article I, Section 2, of the federal Constitution requires that congressional districts within each state be as nearly equal in population as possible, a standard that the Supreme Court and lower federal courts have strictly applied. (Reapportionment: Law and Technology, p. 6, and cases cited therein.) In 1972, the U.S. District Court, Eastern District of Kentucky, ruled unconstitutional the congressional redistricting plan enacted by the 1972 Regular Session of the General Assembly because it contained an overall deviation of 1.44% from the mathematical ideal and could be improved upon. (Wiedeman v. Commonwealth.) The 1972 Extraordinary Session of the General Assembly revised the plan so that the smallest congressional district was only 399 people (or 0.0869%) under the ideal size and the largest district was only 489 people (or 0.1062%) over the ideal size, for an overall deviation from mathematical equality of less than two-tenths of one percent.

Sections 31 and 33 of the Kentucky Constitution establish the following criteria for the General Assembly in redrawing state representative and senatorial districts:

(1) Use single-member districts, 100 for the House of Representatives and 38 for the Senate;

(2) Redistrict every ten years dating from the first redistricting [in 1893] under the 1891 Kentucky Constitution;

(3) Do not divide counties, except to give a county more than one whole district, and do not add part of a county to another to form a district;

(4) Make districts as nearly equal in population as possible, without dividing any county (except to give it more than one whole district);

(5) Do not add more than two counties together to form a House of Representatives' district unless necessary in order to equalize population;

(6) If inequality of population cannot be avoided, give any resulting advantage to the districts with the most territory; and

(7) Do not create a district in which the counties are not contiguous.

The several criteria established by the Kentucky Constitution inherently conflict with one another, leading to state and, more recently, federal court rulings regarding their relationship to one another and to federal constitutional standards for redistricting. In 1907, the Kentucky Court of Appeals ruled that the prohibition against putting more than two counties in a representative district is subordinate to the equal population standard in Section 33 of the Kentucky Constitution, a position reaffirmed by the court in 1963 (Ragland v. Anderson and Combs v. Matthews). The highest state court has also ruled that the requirement to redistrict every ten years does not bar the General Assembly from redrawing districts before the constitutional deadline in order to correct inequalities that have resulted from past failures to redistrict when prescribed. (Combs v. Matthews.)

In 1962, the U.S. Supreme Court ruled that state legislative redistricting controversies may raise issues that are subject to litigation in the federal courts under the Equal Protection Clause of the 14th Amendment to the U.S. Constitution. (Baker v. Carr.) In a subsequent decision, the Court ruled that the seats in both houses of a two-house state legislature must be apportioned on the basis of population and the districts must be substantially equal in population. (Reynolds v. Sims.) The degree of latitude permissible under the "substantial equality" standard was left to federal court resolution on a case-by-case basis. In 1971, two federal district court decisions were rendered concerning redistricting criteria for the Kentucky General Assembly. In Upton v. Begley, the federal district court ruled that the Kentucky Constitution's prohibition against dividing counties in forming state legislative districts was unconstitutional to the extent that it prevented the General Assembly from achieving the equal population standard required under the U.S. Constitution. In Hensley v. Wood, the district court reaffirmed that position and found the 1971 state legislative redistricting law unconstitutional. The court ruled that overall deviations of 18.92% in the senatorial district plan and 25.49% in the representative district plan, resulting in part from an effort to avoid splitting counties, did not meet federal constitutional standards. The court indicated that districts that were as little as one, two or three percent over or under the ideal size were probably constitutional. Neither of the district court decisions was appealed. The 1972 Extraordinary Session of the General Assembly enacted a redistricting law in which no house or senate district was three percent under or over the ideal size, based on the mathematical equality of population standard, for an overall deviation of less than six percent.

Beginning in 1973, the U.S. Supreme Court has issued several rulings that differentiate between congressional and state legislative redistricting with regard to the equality of population standard, and that have approved state legislative district plans with deviations exceeding standards applied by some lower federal courts, based on their interpretations of previous Supreme Court rulings. In Mahan v. Howell, the Court ruled that a Virginia redistricting plan with an overall deviation of 16.4% was constitutional, although approaching the limit of what would be accepted. The Court required that state to justify its deviation from mathematical equality and found that the degree of deviation was incident to the implementation of a rational state policy: the desire to preserve subdivision boundaries so that some subdivisions could be represented as a unit in a state legislature empowered by the Virginia Constitution to enact local legislation. In other cases, the Court ruled plans with overall deviations of 7.8% and 9.9% constitutional without requiring the state to present a "rational state policy" justification. The Court noted with favor that most of the districts in the latter case were close to the ideal size, with an average deviation of the districts being 1.82%. (Gaffney v. Cummings and White v. Regester.) Whether the Supreme Court's redistricting decisions in the 1980s will follow the standards of the mid-1970s or whether a new standard will emerge for the second round of redistricting since federal court involvement began remains to be seen.

Although federal court decisions on the equality of population issues are of major significance, the Supreme Court has also addressed other controversial subjects relating to state legislative and congressional redistricting, including challenges to plans on the basis of partisan gerrymandering, dilution of minority voting strength, and protection of incumbents. The case law in these areas is not so extensive as that on the subject of equal population. The Supreme Court has upheld a redistricting plan intentionally designed to preserve the existing representation of the two major political parties in the legislature. (Gaffney v. Cummings.) It has suggested that challenges to redistricting plans on the basis that they dilute minority voting strength in violation of the 14th and 15th Amendments to the U.S. Constitution must show a discriminatory intent or purpose, as well as discriminatory effect; but this issue is far from clearly settled. (Reapportionment: Law and Technology, pp. 30-33, and cases cited therein.) In those states that, unlike Kentucky, are covered by Section 5 of the 1965 federal Voting Rights Act, a stricter standard of non-dilution of minority voting strength has been adopted by the Court; and the redistricting plans must be reviewed by federal executive or judicial authorities before they become effective. (Beer v. United States and Georgia v. United States.) The Court has also held that the fact that a redistricting plan seeks to protect incumbents does not in itself constitute a violation of U.S. Constitutional standards. (White v. Weiser.)

Discussion

One alternative available to the General Assembly is to maintain current legislative and congressional districts by not redistricting. The consequences of following this alternative would depend upon whether or not a suit were brought in state or federal court to force redistricting and upon the remedy sought and granted by the court. In some states, the failure of the state legislature to redistrict within a certain length of time automatically results in the legislature's loss of redistricting authority to another entity. (Reapportionment: Law and Technology, p. 63-66, and The Book of the States, pp. 86-87.) There is no secondary redistricting authority prescribed in Kentucky law for congressional or state legislative redistricting. Current federal statutes prescribe the use of existing congressional districts in the event no redistricting plan is enacted by a state that, like Kentucky, has experienced no change in the number of congressional seats to which it is entitled. Based on the fact that cases challenging redistricting plans were filed in the early 1970's in Kentucky, the probable consequence of failing to redistrict would be a suit seeking to force the General Assembly to enact redistricting plans. After allowing a reasonable time for state legislatures to redistrict with no results, federal courts may develop redistricting plans for a state. (Ely v. Klahr.)

As suggested by the discussion of constitutional and case law, the Kentucky General Assembly has several alternatives regarding the relative emphasis it places on each of the legal criteria applicable to state legislative redistricting. For example, the General Assembly could choose to emphasize the population equality standard by achieving the same degree of numerical equality among districts as was achieved in 1972 or to improve upon that degree. On the other hand, the General Assembly might seek to avoid the splitting of counties and hope, if necessary, to justify any resulting deviation among district populations with a "rational state policy" argument, based on the state constitutional prohibition against dividing counties in forming state legislative districts. The consequences of selecting any of these alternatives depend, again, on whether the resulting redistricting plan is challenged in the courts and upon the particular court's interpretation of constitutional and case law.

Finally, the General Assembly has numerous alternatives concerning the actual construction of state legislative and congressional districts within the legal framework provided by constitutional and case law.

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EXECUTIVE REORGANIZATION

Prepared by Gregory Karambellas

Issue

Should the Legislature amend statutes governing executive reorganization authority?

Background

The Governor's authority to reorganize became an issue as a result of two recent reorganizations: reorganizations of the Department of Agriculture, and the Utility and Energy Regulatory Commissions.

Executive Order 81-55 transferred the Department of Agriculture from the Development Cabinet to a newly created Energy and Agriculture Cabinet. It also transferred several divisions and functions of the Department of Agriculture to the Kentucky Council on Agriculture. This action raised the question as to the Governor's authority to reorganize constitutional offices, a question which is currently before the Kentucky Court of Appeals. Opponents of the reorganization argue that the Department of Agriculture, as a constitutional office, is exempt from executive reorganization and is only included in a cabinet for "administrative purposes." KRS 12.020 provides "...where the attached department or administrative body is headed by a constitutionally elected officer such attachment shall be solely for the purpose of dissemination of information and coordination of activities and shall not include any authority over the functions, personnel, funds, equipment, facilities, or records of such department or administrative body."

KRS 278.040, enacted in 1978, replaced a five-member, part-time Public Service Commission with a three-member, full-time Energy Regulatory Commission and a three-member, part-time Utility Regulatory Commission, each with a separate jurisdiction.

In 1980, Governor Brown merged the Energy and Utility Regulatory Commissions into a single Public Service Commission (Executive Order 80-1010). This new commission, composed of three full-time members, was given jurisdiction over all utilities in the state.

Opponents of this action feel that the organization of the Commissions into two separate bodies by statute was a basic policy determination that could only be changed through legislation enacted by the General Assembly.

Executive reorganization authority stems specifically from KRS 12.025, but is closely related to other sections of KRS Chapter 12, notably KRS 12.010 and 12.020. KRS 12.025 was first enacted during the 1960 session and granted the Governor the authority to "establish, abolish, or alter the organization of any statutory administrative department..." Also included was the authority to "...transfer functions, personnel, funds, equipment, facilities, and records from one department to another." The Governor was granted this authority in order to "promote greater economy, efficiency and improved administration."

At that time, KRS 12.020 divided the organization of state government into three separate and distinct groups: (1) Constitutional Administrative Departments; (2) Statutory Administrative Departments; and (3) Independent Agencies. Only statutory administrative departments were subject to reorganization. However, amendments of KRS 12.025 in 1962 and 1974, combined with revision of KRS 12.020, subsequently confused the question as to the extent of executive reorganization authority.

The 1962 amendment included "agencies" under the executive reorganization authority, but the definition of "agency" was removed in 1974. Also in 1962, the category of independent agencies (originally exempt from executive reorganization) was removed, and those agencies were placed under various departments, subject to reorganization.

In 1974, the entire state organizational system was restructured into a cabinet system. However, the wording of KRS 12.025 was never amended to reflect the changes in the system.

Executive reorganization is defended on the grounds that since the General Assembly meets only for 60 days every two years, changes should take place immediately. The Governor's office, working full-time and being constantly in touch with the agencies, is considered to have the experience and the expertise to most efficiently alter the organizational structure of state government. The General Assembly must approve or disapprove executive reorganizations effected during the interim between sessions. Therefore, legislative review is provided.

The reorganization authority has been attacked on the grounds that it is an overly broad delegation of legislative discretion, that it should not extend to the various administrative bodies (i.e. boards, commissions, etc.) of state government, and that it is not within the Governor's authority to reorganize constitutional departments.

Discussion

The statutes governing reorganization could be amended to prohibit the reorganization or abolition of any department, agency, or administrative body specifically created by statute. This course would effectively remove most of the Governor's authority to reorganize, since virtually all departments, agencies and administrative bodies are statutorily created.

The executive authority to reorganize could be limited to the establishment, or abolition only of those governmental units designated as departments. While this approach would preclude reorganization of authorities, boards, and commissions, the Governor's ability to reorganize departments, the most important divisions of state government, would not be impaired.

A return to the wording of KRS Chapter 12 as it existed in 1960 would permit the reorganization of statutory departments but would preclude executive reorganization of constitutional offices and agencies designated "independent" by the General Assembly. This action would insure that only the General Assembly could reorganize constitutional offices, departments and independent agencies.